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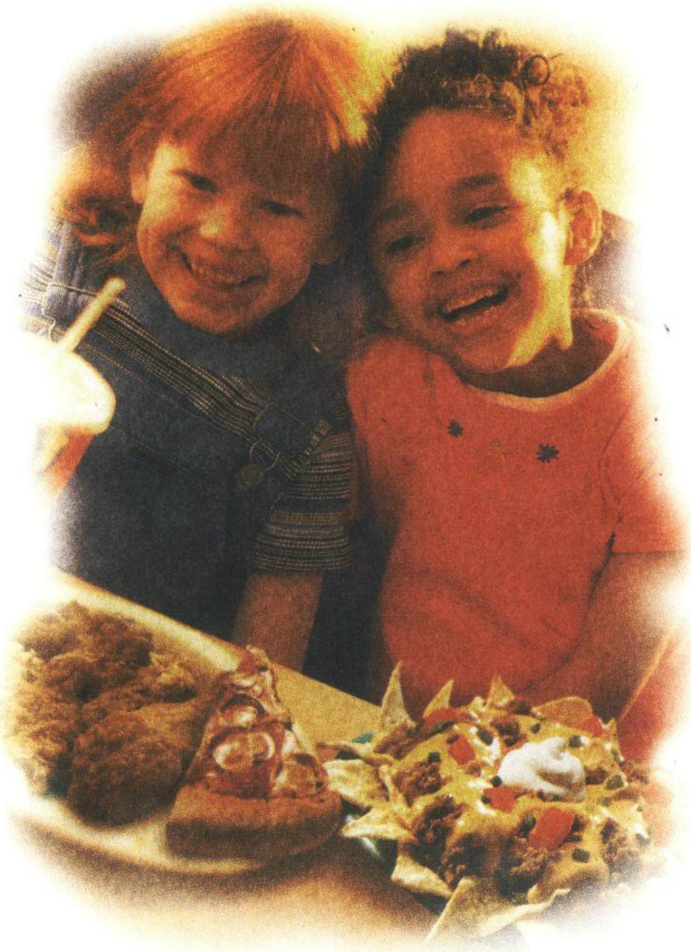

1997 Annual Report

Tricon

Yum!

KFC

TACO BELL

Pizza Hut

Alone we're delicious. Together we're YUM!

Financial Highlights

(in millions, except for unit and share data)

	1997	1996	Change Better (Worse)
System sales[a]	**$20,500**	$20,300	1 %
Number of restaurants[a]:			
System	**29,712**	29,096	2 %
Company	**11,207**	12,883	(13)%
Company revenues	**$ 9,681**	$10,232	(5)%
Ongoing[a][b]			
Operating profit	**649**	591	10 %
Net income	**203**	126	61 %
Per Pro Forma Basic Share[c]	**1.34**	.83	61 %
Reported			
Operating profit	**241**	372	$(131)
Net loss	**(111)**	(53)	$ (58)
Per Pro Forma Basic Share[c]	**(.73)**	(.35)	$ (.38)
Cash flows provided by:			
Operating activities	**810**	713	14 %
Refranchising proceeds	**770**	355	$415

(a) Excludes the Non-core Businesses. The Non-core Businesses incurred losses of $44 ($26 after-tax or $.17 per basic share) and $261 ($200 after-tax or $1.32 per basic share) in 1997 and 1996, respectively. See Note 1 to the Consolidated Financial Statements.

(b) 1997 excludes the fourth quarter unusual charge of $530 ($425 after-tax or $2.80 per basic share) and the favorable impact relating to other facility actions of $163 ($137 after-tax or $.90 per basic share). 1996 excludes the favorable impact relating to facility actions of $37 ($21 after-tax or $.14 per basic share). See Note 4 to the Consolidated Financial Statements.

(c) Assumes the 152 million shares issued at Spin-off had been outstanding for all periods presented.

Tricon Global Restaurants, Inc.

1441 Gardiner Lane Louisville, KY 40213

(502) 874-1000

Internet: www.triconglobal.com

Worldwide System Units

Compounded Annual Growth Rates, Year-End 1992-1997

	1992	1993	1994	1995	1996	**1997**	5-Year Growth
U.S.							
KFC	5,055	5,094	5,115	5,137	5,108	**5,120**	–
Pizza Hut	7,608	7,965	8,348	8,648	8,759	**8,698**	3%
Taco Bell	3,914	4,495	5,358	6,126	6,669	**6,768**	12%
Total U.S.	16,577	17,554	18,821	19,911	20,536	**20,586**	4%
International							
KFC	3,674	3,939	4,292	4,492	4,753	**5,117**	7%
Pizza Hut	1,846	2,295	2,920	3,322	3,631	**3,836**	16%
Taco Bell	102	139	179	169	176	**173**	12%
Total International	5,622	6,373	7,391	7,983	8,560	**9,126**	10%
Total	22,199	23,927	26,212	27,894	29,096	**29,712**	6%

Breakdown of Worldwide System Units

Year-End 1997

	Company	Joint Venture	Franchised	Licensed	Total
U.S.					
KFC	1,850		3,190	80	5,120
Pizza Hut	3,823		3,581	1,294	8,698
Taco Bell	2,149		2,826	1,793	6,768
Total U.S.	**7,822**		**9,597**	**3,167**	**20,586**
International					
KFC	1,125	465	3,473	54	5,117
Pizza Hut	1,098	625	1,960	153	3,836
Taco Bell	72		67	34	173
Total International	**2,295**	**1,090**	**5,500**	**241**	**9,126**
Total	**10,117**	**1,090**	**15,097**	**3,408**	**29,712**

Tricon ownership is down to 38%.

Unit totals include 1,451 licensed kiosks, 77 Company specialty outlets, 29 franchised specialty outlets and 1,714 licensed specialty outlets. KFC includes 233 Company combined Taco Bell units and 110 franchise-combined Taco Bell units.

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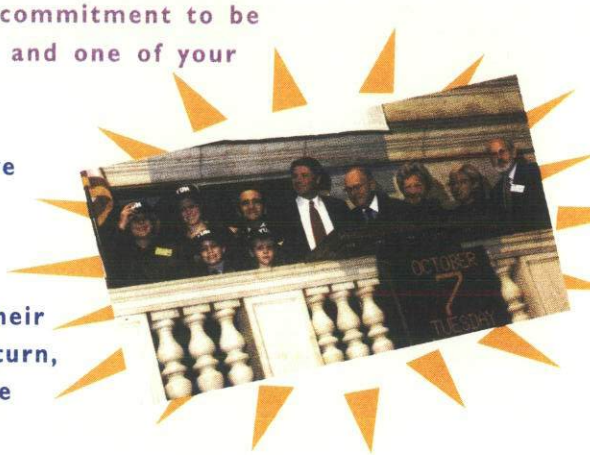
Dear Friends,

October 7, 1997 - Founders Day for the people and shareholders of Tricon Global Restaurants. The day we declared our independence from PepsiCo and made our commitment to be the highest performing restaurant company in the world - and one of your best investments.



While we couldn't imagine being in a more fun business, we couldn't be more serious about delivering on this promise. And there's no question in our minds we'll be able to do just that by being a focused restaurant company, led and operated by people who love the restaurant business - people who put their people first (train them, recognize them, reward them). In turn, they'll satisfy more customers, and guess what, you'll take more money to the bank than anyone else. That's the real key to our business.

A NEW KIND OF COMPANY

This is our first Annual Report. It will give you a sense of the enthusiasm we all have for our tremendous opportunity to grow Pizza Hut, Taco Bell and KFC around the world. We have been endowed with three of the globe's most recognized icons, and we're certain we have barely begun to scratch the surface of growth potential at hand. So what's going to be different? That's a fair question that deserves an answer. While we've just begun our new company, we've made much progress these last three months, and we'd like to share that with you. We're focused on five key growth strategies:

First, we're dramatically improving our operations execution by recognizing the Restaurant General Manager is our number one leader. While our executive teams set strategy and allocate resources, it's the RGM who builds the team at the restaurant that satisfies our customers. We learned an undeniable truth as we completely turned around KFC these last four years: when we have great RGMs, we have well-run restaurants that make lots of money. And the exact opposite happens when we don't. So we plan to do the very best job helping our number one leaders be better coaches and master the key operating processes.

From our training programs, to renaming our headquarters buildings "Restaurant Support Centers" and uniquely placing our RGMs' picture on our stock certificates, everything we do is geared to help our RGMs better serve our customers and have fun recognizing those who are doing it very well. Importantly, we're paying for performance. We've launched **YUMBUCKS**, an innovative program that grants each RGM an initial $20,000 in stock options, with the likelihood of more based on the annual performance of his or her restaurant.

By the way, we want an "act like an owner" mindset across the entire company. That's why we now require all of our executives to buy stock in the company, and offer most of our employees the opportunity to purchase stock at a discounted price as part of their savings plan. We think it's a great idea to have our employees have a little "skin in the game," just like you.

Second, in addition to improving sales and margins by making the RGM our number one leader, we intend to drive consistent same store sales growth with marketing innovation. Historically, sales growth comes from new products, new dayparts, price value initiatives, heavy user promotions and superior service systems.

We have begun to build a pipeline of initiatives for all of our companies in each of these categories and will eventually introduce them to our customers with powerful break-through marketing. The average restaurant sales for our three brands is a little more than half of McDonald's average restaurant sales today. We have an underutilized asset base with plenty of room to grow. We'll be going after this growth with some major new products in '98, along with tie-ins to hot new promotional properties.

Third, we will make multi-branding and consolidated market planning a big idea. This last year, we've had enormous success testing the combination of several of our brands under the same roof. For example, we've added Taco Bells to KFC, and have driven sales increases far in excess of the incremental investment made. We also have placed all three of our brands in one restaurant, and sales are well over $2 million.

Multi-branding
1+1=3

We believe, over the next eight years, we can add 2,000 to 4,000 new multi-units in the United States alone, and create a potential $250 million after-tax business. What's more, we now have consolidated market planning so we can develop each of our markets working closely with the interest of each of our brands. Believe it or not, before the spin-off, our companies actually bid against each other for real estate sites. Those days, thank goodness, are over.

Next, we have just begun to operate as one system and leverage our enormous scale. That's a huge opportunity, and unique to Tricon. Just think about it. We have 30,000 restaurants - 30,000 laboratories - that give us a tremendous opportunity to share best practices and drive productivity. So rather than have three of everything, we have the ability to share services - everything from information technology and accounts payable to ingredient purchasing and media buying.

As an example, we've begun to consolidate our television network media buying, making Tricon the fifth largest U.S. network buyer. Before, our three brands were independently ranked in the top 50. Our goal is to have the lowest cost structure in the industry and to wipe out every redundancy. We also intend to work closely with our franchise partners, making sure both company and franchise operations move with a unity of purpose.

Last, but probably most important long-term, is our strategy of focused international growth. While we've previously planted the flag in over 100 countries, you can count on us to target the areas of greatest opportunity for future development and investment. We plan to substantially increase our return on assets while we focus our company investment in seven key countries.

Having just returned from China and Korea, we can tell you our brands are even more popular in Asia than they are in the United States. Despite the economic slowdowns, our restaurants were absolutely packed! Although we face an uncertain Asian market economy, we intend to leverage our past experience in volatile currency markets like Mexico and Poland, where we learned to stay the course and grow our business for the long-term. Importantly, our international business has experienced, local teams capable of driving impressive new unit and base business growth.

SOLID PROGRESS IN 1997

If you'd ask our financial team, they'd say we had a fair year, based on almost any financial measure. But from our perspective, the most honest thing we can say about '97 is we're glad it's over. Launching one of the biggest spin-offs in history and taking on $4.6 billion of debt was an enormous task. So 1997 was a solid year, but basically it was a year of transition driven on PepsiCo's terms, not ours. We did, however, make a lot of progress in the last three months of the year as a new, independently-traded company.

We established new leadership teams, new management processes and formed the Tricon financial group from scratch. We also made a tough but necessary decision to take a $425 million after-tax charge to ensure we were structured in a manner that would allow us to run the business in the right way for the long term.

By taking this unusual, mostly non-cash, charge we 1) strengthened Pizza Hut's U.S. asset base by closing or refranchising hundreds of marginal stores; and 2) focused our international scale in high-growth markets, while refranchising others. As a result, we eliminated almost all of our cash-losing units at Pizza Hut. And we materially reduced the management task in our international business.

In the midst of all this change, we delivered a strong 14 percent growth in operating profits to $662 million, before interest, income taxes, unusual charges and facility actions. When you factor out $13 million in operating profits from non-core businesses sold in 1997, our core business operating profits (from the worldwide operations of Pizza Hut, Taco Bell and KFC,) were $649 million, up a solid 10 percent. We also improved our restaurant margins by almost one point and boosted our return on net assets by over three points.

Our 1997 earnings were $314 million, excluding the impact of the fourth quarter unusual charge. Operating Earnings Per Share were $1.34 for the core businesses, up a very strong 61 percent before the charge and facility actions. Including these items, we reported a net loss of $111 million, or ($.73) per basic share.

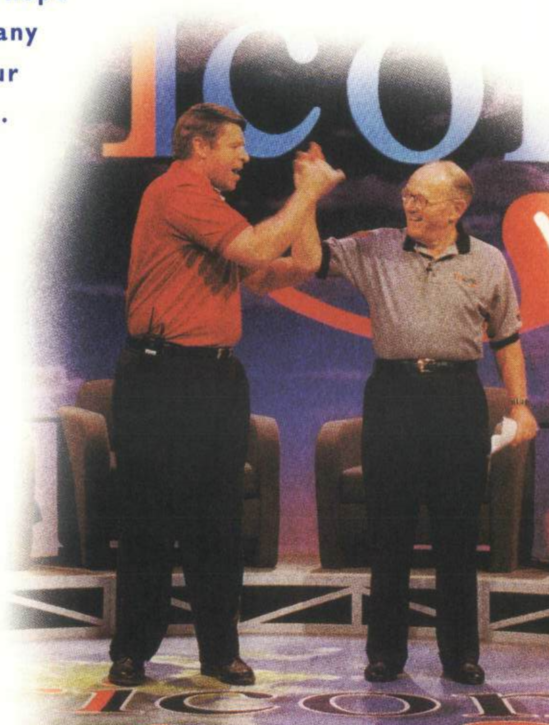
You should also know that we have the cash-generating capability that allows us to aggressively pursue attractive returns on the opportunities we face. We generated more than $1.5 billion of cash flow from base operations and refranchising. We will be able to invest in the ongoing needs of the business and build at a rate that will make us a great investment.

We want to thank our nearly 350,000 employees, and numerous franchisees across our system, for their hard work, dedication and commitment to helping us make all of this significant progress during 1997. We'd also like to especially acknowledge our new Board of Directors, the most able any company could hope for. We couldn't have had a more extraordinary group of people at our side as we created our new company.

LOOKING AHEAD

Our operating base has been established and we're committed to "show you the money" going forward. As we look ahead over the long-term, Tricon is going to be a company that stands for growth. Growth in earnings - growth in shareholder value - and growth in share of market for all three of our brands. We are committed to low double digit growth in operating profits, before facility actions - above-industry growth in same store sales - and growth in Operating Earnings Per Share in the mid-teen range.

We enter 1998 with real confidence that we are heading for a strong year, and an even brighter future. In the following pages, we'd like to give you a snapshot of the progress we've made at each of our businesses. We hope you'll recognize we're establishing a different kind of company - one that leverages our newly-combined scale, is built on our RGM #1 culture, and will deliver consistent long-term growth. We know you'll come to the same conclusion we have about our three great brands and our new opportunities at Tricon: Alone we're delicious - together we're YUM!



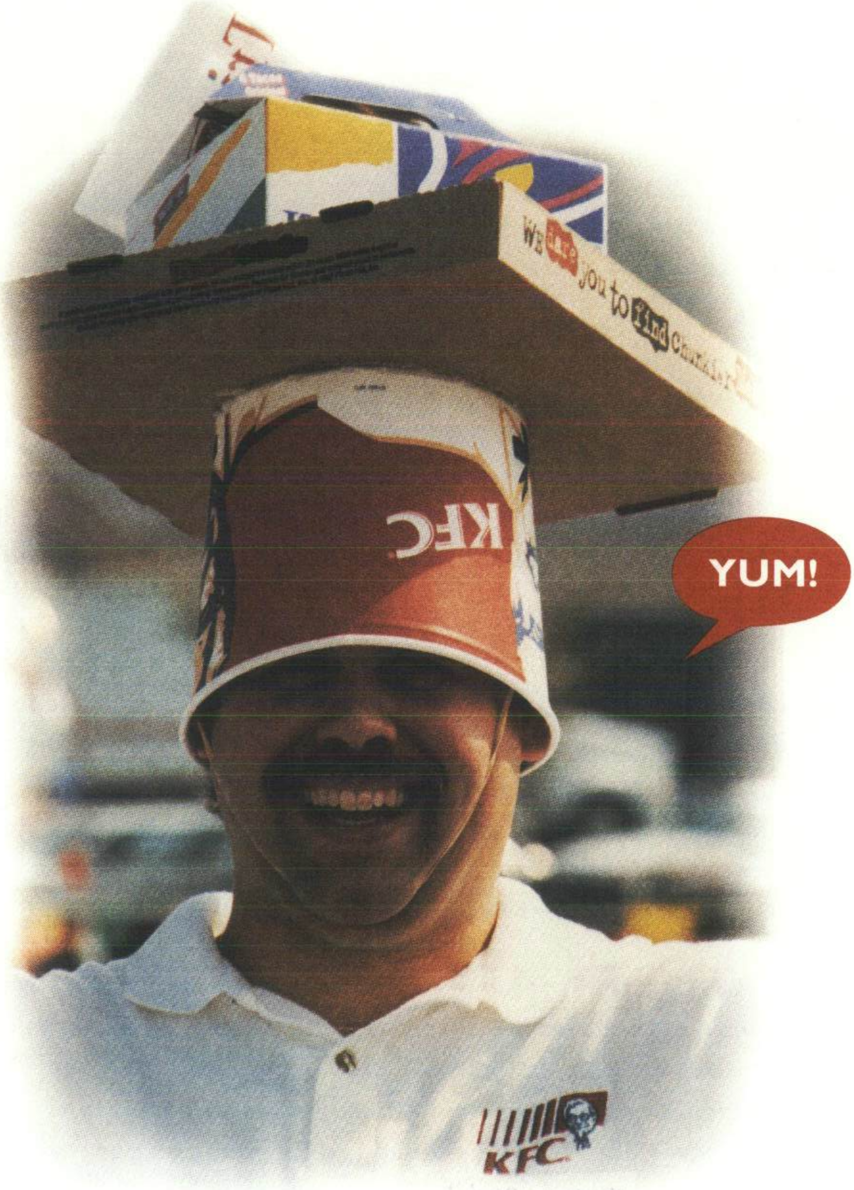
On behalf of all of us at Tricon, in our restaurants and throughout our franchise system, YUM to you,

Al Pearson

Andrall E. Pearson
Chairman and CEO

David Novak

David C. Novak
Vice Chairman
and President



Having some fun on
Founders Day

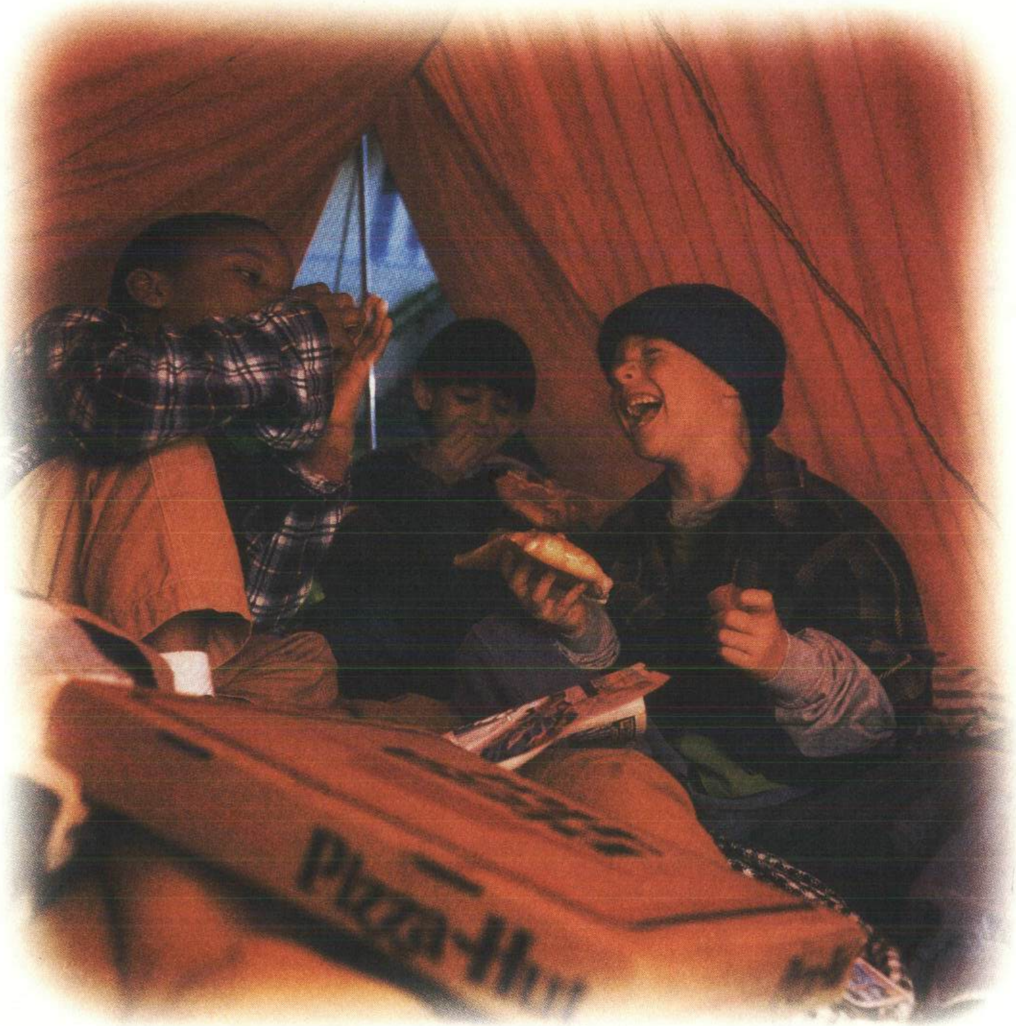
WelcYUM to Tricon!

While our public ownership under the name Tricon Global Restaurants, Inc. is new, our company is not. For years, consumers have been enjoying our great-tasting chicken, pizza and Mexican-style food. In fact, we're the world leaders in each of these restaurant food categories. Every week, KFC, Pizza Hut and Taco Bell serve more than 150 million people in nearly 30,000 restaurants in over 100 countries. More restaurants around the world than any other company.

If you've been in one of our restaurants lately - and we hope you have - you'll notice that we strive to create a special kind of eating experience. Our employees are friendly. Our food is served hot, and freshly prepared for you. People are smiling. That's because they're thinking "YUM!" From our Colonel Sanders' finger lickin' good chicken, to our hot, freshly made pizzas and zesty tacos and burritos. You've gotta admit - our food's delicious, and no one else serves chicken, pizza or tacos like we do.

Putting a YUM on people's faces around the world has become our company's mission. We even used YUM for our ticker symbol on the New York Stock Exchange, because those three letters speak volumes about our company and the experience we want to create for our customers. We know we'll establish lifelong customers by serving 'crave and rave' food offered at a 'come-back value.' Our 350,000 employees and franchisees across Tricon work in customer-focused teams, committed to making YUM happen each and every time someone orders our food.

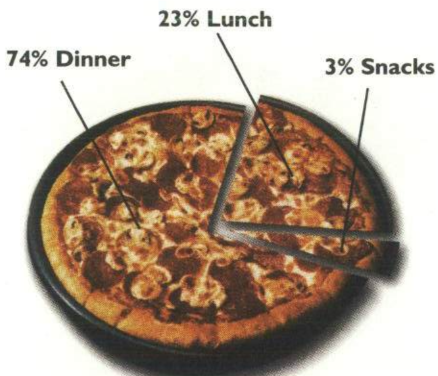
We're off to a solid start and have made much progress in Tricon's first three months. So let's take a look at how our operating companies performed in 1997.



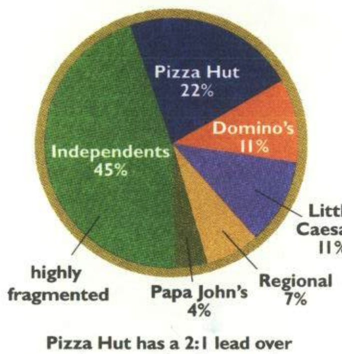
Delivery is a strong driver of sales for Pizza Hut.

*Traditional units only.

Dayparts



Pizza Industry Sales



Pizza Hut has a 2:1 lead over our closest national competitor.

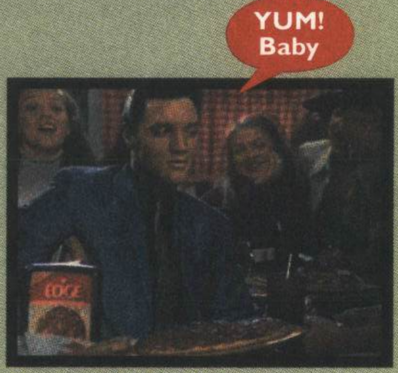
Pizza Hut USA

Pizza Hut first opened its doors in Wichita, Kansas, in 1958, serving hot, delicious pizzas under its distinctive bright red roof. Today, Pizza Hut is the largest pizza chain in the United States, with a systemwide market share of 22 percent. Not only do consumers rate Pizza Hut America's 'most popular' pizza, we've consistently been named "America's Best Pizza Chain" by numerous newspapers, magazines and consumer publications, as well.

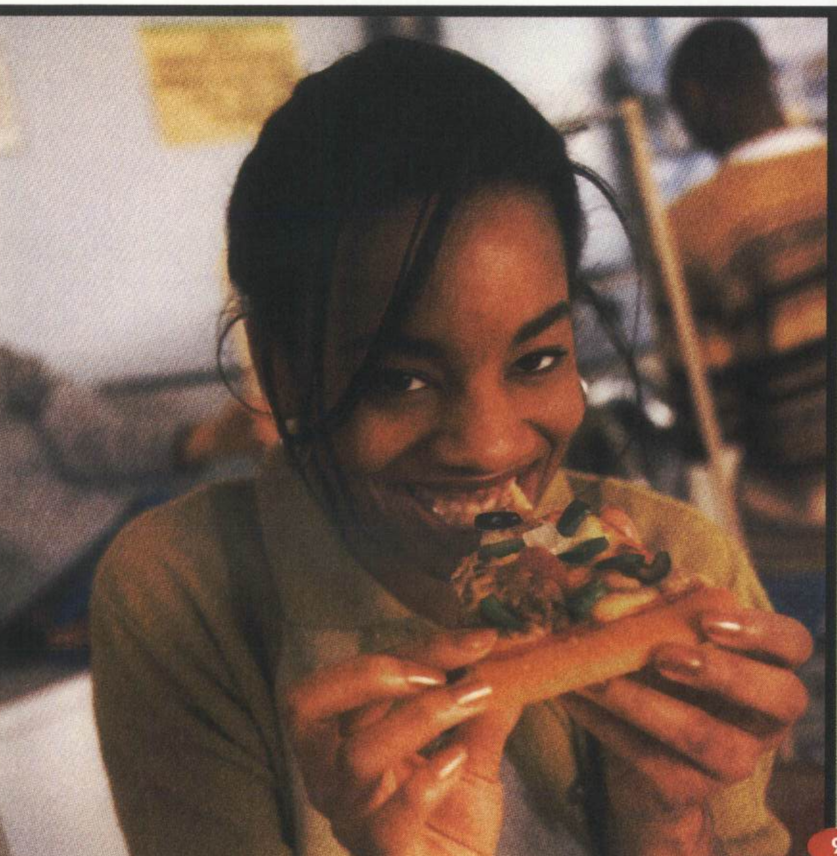
Mike Rawlings making a "Big Cheese Award"

The vision driving this success is pretty simple: "Be the best at making and serving the best pizza in America." And last year, our great pizza got even better. We greatly improved our product quality with sliced fresh vegetables and meatier toppings. Consumers responded, and rated us at an all-time high on topping abundance and quality - beating out the majority of our national competitors with our most popular pizzas.

We're not only improving our products, we're also improving our operations by running great restaurants and by building customer-focused teams who execute operations so well it drives sales. At the same time, we're optimizing our asset portfolio by closing underperforming stores, consolidating overbuilt markets and selectively refranchising.



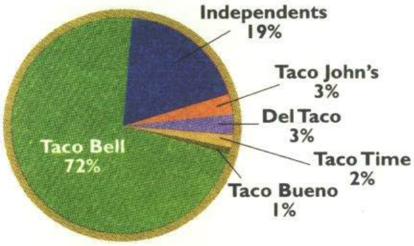
And we're creating excitement in the marketplace. You may have felt the buzz about "The Edge" pizza, our newest pizza innovation, launched late in 1997. It continues to drive sales and transactions by offering a unique thin crust, zesty flavors and toppings that go right to the edge. Even the "King of Rock'n'Roll," Elvis Presley, has been to the edge and back.



All of these actions, along with competitive pricing efforts, have resulted in positive transaction momentum, improved profits and same store sales growth late in the year. In fact, our same store sales went from -8 percent in the first quarter, to +5 percent in the fourth quarter, ending the year strongly. And the positive momentum continues today.

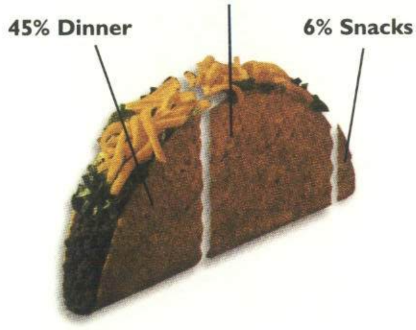
Have you been to The Edge?

Mexican Quick Service Industry Sales

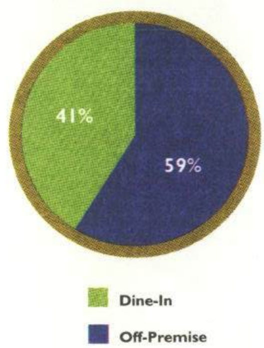


Taco Bell has a commanding market share lead, ahead of independent stores and regional chains.

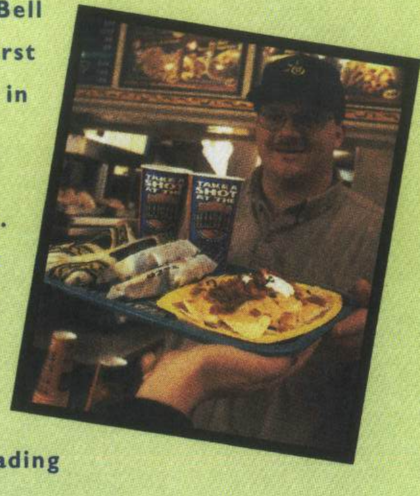
Dayparts



Sales by Distribution Channel



Taco Bell USA



Taco Bell has been a story of remarkable growth since Glen Bell opened his first restaurant in 1962. Two years later, he sold his first franchise unit, and by the time PepsiCo acquired the company in 1978, it had grown to over 900 units.

Today, Taco Bell dominates more than two thirds of the U.S. Mexican quick service market, has no national competitors and serves our spicy, zesty Mexican-style tacos, burritos and nachos to more than 55 million people every week in 6,800 company, franchised and licensed restaurants. What's more, lunch sales account for almost 50 percent of Taco Bell's business - making it the leading lunch business of each of our three concepts.

And, after two straight years of grappling with negative same store sales (-4 percent in 1995 and -2 percent in 1996), Taco Bell recorded same store sales growth of +2 percent in 1997. Restaurant margins grew three points, leading to significantly stronger operating profits, and system sales reached $4.8 billion.

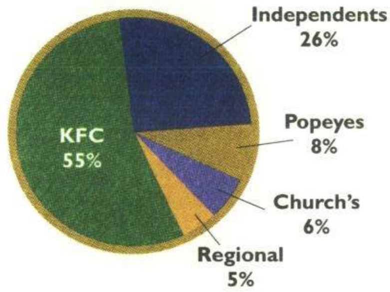
This progress was no accident. We enhanced our food quality by introducing beefier, zestier taco meat, thicker chunks of cheese, more authentic corn taco shells and tortilla chips, and a hot sauce that puts most chili peppers to shame! Next, we improved operations by placing a Restaurant General Manager in each restaurant for the first time in more than 5 years. We recognized our operations suffered when we took management out of restaurants several years back to save cost. So we've reinvested in the business, and are creating an RGM #1 culture throughout the organization. But most exciting is Taco Bell's new breakthrough marketing. We've emerged as one of the best in the industry at identifying hot movies that teens love - like Star Wars and Batman & Robin this year. And we introduced America's newest celebrity - that lovable little chihuahua who's now starring in our commercials.

Peter Waller knights the "Royal Order of the Pepper Award"

Taco Bell rules!

Yo quiero Taco Bell.

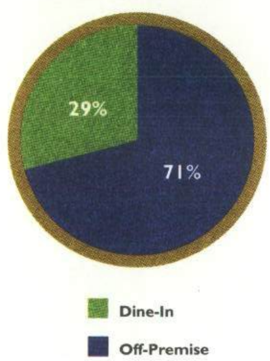
Chicken Industry Sales



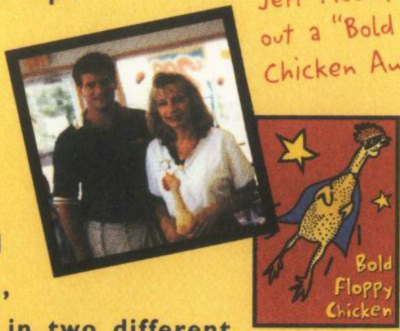
KFC has over half of the market, well ahead of other national chains.

Dayparts

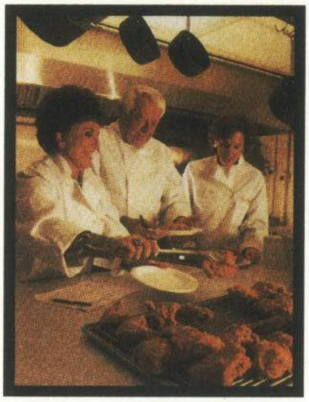
Sales by Distribution Channel



Colonel Harland Sanders started KFC back in 1952 at the ripe young age of 62! His recipe for the best chicken in the world was made with a special cooking process and a secret blend of 11 herbs and spices - the same secret blend we use today in our Original Recipe chicken. The recipe is such a guarded secret that it's known by only a few people and locked in a vault in Louisville, Kentucky. The spices are blended in two different factories so no one place has the entire recipe. The Colonel made his first franchise deal on a handshake in 1952, founding what has become the most successful chicken restaurant chain in the world. KFC was bought by PepsiCo in 1986. By then, it had 6,600 units in 55 countries.



Jeff Moody hands out a "Bold Floppy Chicken Award"



Chef's Council franchisees helping us make great products

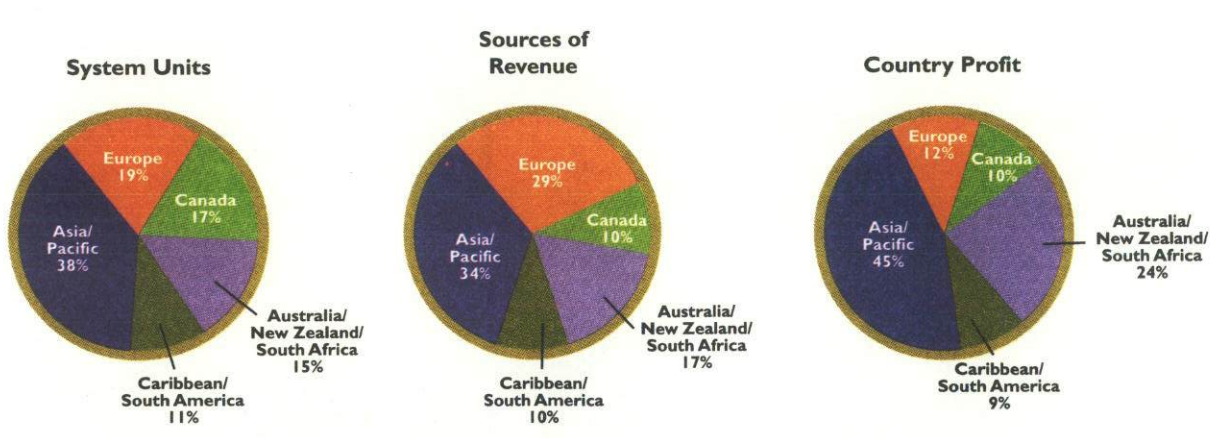
Today, KFC has more than 10,000 units in over 79 countries, with U.S. system sales of $4 billion. Each week nearly 49 million customers come through KFC's doors for the chicken they crave, made from recipes no one can match - like Original Recipe, Extra Tasty Crispy, Tender Roast, Colonel's Crispy Strips and Chunky Chicken Pot Pie.

KFC is a true success story. Just four years ago, some so-called experts thought fried chicken was a dead bird. Many thought roasted chicken restaurants would drive our sales down. But the great popularity of our products proved naysayers wrong. In fact, our same store sales were up for the fourth year in a row - up 2 percent in 1997. Restaurant margins increased 1.5 points - the fourth consecutive year we've significantly improved margins. And our base operating profit was up in the low double digits on a comparable basis.

Team members having a little fun at work.

A lot of this success is due to a renewed focus on product quality, improved operations and new product offerings. But the most significant change these last four years is a new culture that recognizes our RGMs and their teams as the most important leaders in the system. As you've seen, we're using KFC's model for success at our other operating companies, as well.

"Isn't it time for some really good chicken?"



Asia/Pacific is the largest contributor to revenues and profits.

Tricon Restaurants International

A few years ago, PepsiCo consolidated the international operations of KFC, Pizza Hut and Taco Bell into a separate operating company, now called Tricon Restaurants International (TRI). Representing 102 countries and territories, 9,100 restaurants and more than 120,000 employees, TRI serves the same great-tasting chicken, pizzas and tacos that our U.S. customers have come to love.

Pete Bassi making the "TRI Globe Award" presentation

The global quick service restaurant business represents a tremendous growth opportunity for Tricon. We now have a 13 percent share of a $160 billion market, and our goal is to grow that. In 1997, we made tremendous strategic progress in our international business. In the past, we reached for growth in far too many countries where we operated stores. So shortly after the spin-off, we redirected our international business - focusing on building scale in high-growth potential company markets, while refranchising others.

The fourth quarter charge this year allowed us to write down the carrying value of 305 stores we plan to refranchise and 143 stores we plan to close in 1998. All of this will clear the way for us to focus on further developing seven key markets where we have the opportunity - and resources - to take advantage of growth. Those markets represent almost half of TRI's operating profit from company restaurants, and will receive 85 percent of our new unit capital. At the same time, we're exiting company ownership in several other countries where we lack the critical mass to operate profitably - refranchising these to new or existing franchisees who we expect will operate them more efficiently.

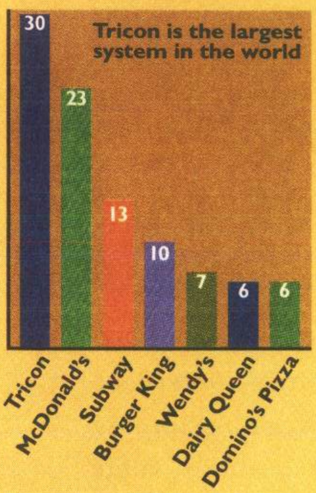
A scene from our Pizza Hut commercial with the "President of Peristroika," Mikhail Gorbachev

Lastly, as you know, the Asian market economy began having difficulties in late 1997. Asia represents about 54 percent of our international operating profits and 37 percent of TRI's system sales. The region's devaluation and economic downturn have hurt retail sales across most industry segments, including ours. That said, Asia represents a huge growth opportunity, and we plan to take advantage of it. We recognize our investment there is for the long-term, as it was in other recently volatile currency markets like Mexico and Poland.

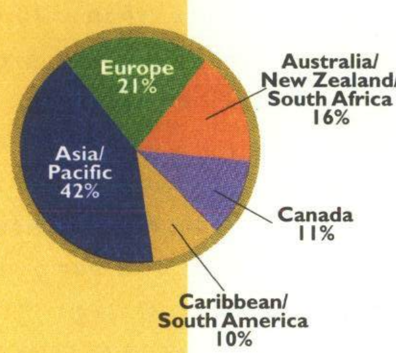
In those markets, we weathered the storm and now have the brands consumers love. In fact, our sales in Mexico were up 39 percent in 1997, and we had strong growth in profits as well. This experience helps illustrate why we're optimistic about our long-term potential in Asia, despite today's difficulties. So, while we continue to monitor the market dynamics, experience tells us to be patient and optimistic about our potential.

Tricon Facts

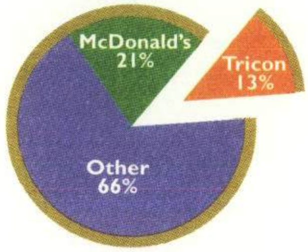
Worldwide Units
(Thousands)



Source of System Sales in International Restaurants



Worldwide Quick Service Restaurant Retail Sales
(% of Total Retail Sales)

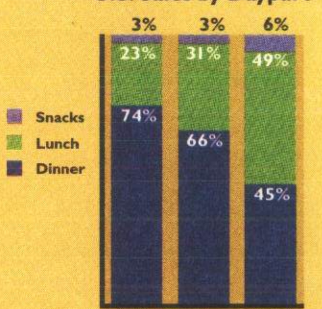


Worldwide System Sales
($ in billions)
Compounded Annual Growth Rates

	1992	1993	1994	1995	1996	**1997**	5-Year Growth
KFC	$ 3.4	$ 3.4	$ 3.5	$ 3.7	$ 3.9	**$ 4.0**	3%
Pizza Hut	4.3	4.8	4.9	5.1	4.9	**4.7**	2%
Taco Bell	3.2	3.7	4.2	4.4	4.6	**4.8**	9%
Total U.S.	10.9	11.9	12.6	13.2	13.4	**13.5**	4%
Total International	4.8	5.4	5.6	6.5	6.9	**7.0**	8%
Total	$15.7	$17.3	$18.2	$19.7	$20.3	**$20.5**	6%

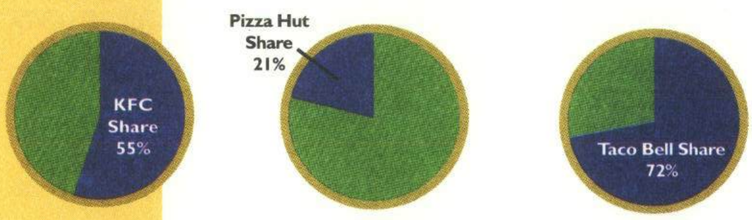
Excludes sales from Non-core Businesses.

U.S. Sales by Daypart



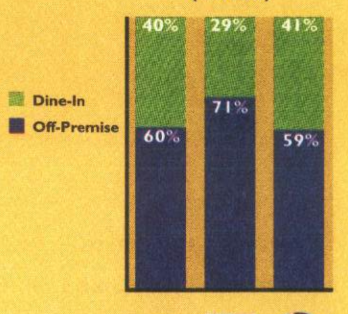
Sales across our brands are driven by dinner and lunch. Marketing innovations like new dayparts can help grow sales.

U.S. Quick Service Restaurant Segment



Chicken, Pizza and Mexican were the fastest growing leading QSR segments and we have the biggest share in each category.

U.S. Sales by Distribution Channel
(% of sales)



Most of our sales come from off-premise dining, which reflects customers' desire for convenient food.

Average U.S. System Sales Per Unit
($ in thousands)
Compounded Annual Growth Rates

	1992	1993	1994	1995	1996	**1997**	5-Year Growth
KFC	$684	$685	$706	$733	$775	**$786**	3%
Pizza Hut	612	651	634	651	620	**630**	1%
Taco Bell	866	925	953	925	886	**972**	2%

Excludes sales from kiosks and other special outlets as well as Non-core Businesses.

Management's Analysis

Introduction

On October 6, 1997 (the "Spin-off Date"), the worldwide operations of KFC, Pizza Hut and Taco Bell (the "Core Business(es)") became an independent, publicly owned restaurant company known as TRICON Global Restaurants, Inc. through a spin-off from our former parent, PepsiCo, Inc. (the "Spin-off"). See Notes 2, 3 and 4. The Spin-off marked the beginning of a company focused solely on the restaurant business and our three well-recognized brands which together have more outlets worldwide than any other single quick service restaurant ("QSR") company. Separately, each brand ranks in the top ten among QSR chains with regard to U.S. system sales and units. Internationally, our 9,000 plus units make us the second largest QSR company outside the United States.

This Management's Analysis is structured in four major sections. The first section provides an overview and focuses on items that either significantly impact comparability or are anticipated to significantly impact future operating results. The second analyzes results of operations; first on a consolidated basis and then separately for our U.S. and international businesses. The final sections address consolidated cash flows and financial condition. Discussion of certain market risks and our cautionary statements follow these major sections.

This Management's Analysis should be read in conjunction with the Consolidated Financial Statements on pages 31-49 and the Cautionary Statements on page 30. All note references herein refer to the Notes to the Consolidated Financial Statements on pages 35-49. Tabular amounts are displayed in millions except per share and unit count amounts, or as specifically identified. All pro forma earnings per share calculations assume that the 152 million shares issued at Spin-off had been outstanding for all periods presented.

Worldwide Marketplace

Our worldwide businesses operate in highly competitive markets that are subject to both global and local economic conditions, including the effects of inflation, commodity price and currency fluctuations, governmental actions and political instability and its related dislocations. Our operating and investing strategies are designed, where possible, to mitigate these factors through focused actions on several fronts, including: (a) enhancing the appeal and value of our products through brand promotion, product innovation, quality improvement and prudent pricing actions; (b) providing excellent service to customers; (c) increasing worldwide availability of our products; (d) forming alliances to increase market presence and utilize resources more efficiently; and (e) containing costs through efficient and effective purchasing, distribution and administrative processes.

In 1997, as a percentage of our Core Businesses, our international business accounted for 34% of system sales, almost 25% of Company revenues, and 22% of operating profit before unallocated expenses, foreign exchange losses, facility actions and unusual charges. We believe that, despite the inherent risks and generally higher general and administrative costs of operations, key international markets will continue to be high priority investment targets due to their substantial growth potential. It is, therefore, important to consider that movements in currency exchange rates not only result in a related translation impact on our earnings, but also can result in significant economic impacts that affect operating results. Changes in exchange rates are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. In addition, material changes may cause us to adjust our financing, investing and operating strategies; for example, promotions and product strategies, pricing and decisions concerning capital spending, sourcing of raw materials and packaging (see discussion on Asia below). The following paragraphs describe the effect of currency exchange rate movements on our reported results.

As currency exchange rates change, translation of the income statements of our international businesses into U.S. dollars affects year-over-year comparability of operating results. Material effects on comparability of sales and operating profit arising from translation are identified in Management's Analysis of operating results. By definition, these translation effects exclude the impact of businesses in highly inflationary countries, where the accounting functional currency is the U.S. dollar.

Changes in currency exchange rates can also result in reported foreign exchange gains and losses, which are included as a component of general, administrative and other expenses. We reported a net foreign exchange loss of $16 million in 1997, $5 million in 1996 and $1 million in 1995. These reported amounts include translation gains and losses arising from remeasurement into U.S. dollars of the monetary assets and liabilities of businesses in highly inflationary countries as well as transaction gains and losses. Transaction gains and losses arise from monetary assets such as receivables and short-term interest-bearing investments as well as payables (including debt) denominated in currencies other than a business unit's functional currency.

Asian Economic Events

Asian operations in such countries as China, Japan, Korea, Singapore and Thailand, among others, comprised approximately 37% of our international system sales for 1997. The economic turmoil and weakening of currencies throughout much of Asia against the U.S. dollar during 1997 has created a difficult retail environment and has had an adverse effect on our operating results beginning late in 1997. Despite this, we will continue to seek out investment opportunities in certain parts of Asia. Lessons learned, in the recent past, in other countries such as Mexico in 1996 and 1995 have helped us identify opportunities to mitigate the impact of these economic events. These include working with our suppliers to reduce costs and increasing the value of our product offerings. The complexities of the international environment in which we operate make it difficult to accurately predict the ongoing effect of foreign currency movements on results of operations. Related effects will be reported in our financial statements as they become known and are estimable.

Selected highlights of our recent operating results in Asia are as follows:

	1997 Amount	% B(W)[a] vs. 1996	1996 Amount
Revenues	**$509**	24	$412
% of Total International	**22%**		18%
Operating Profit	**$ 92**	6	$ 87
% of Total International[b]	**54%**		57%

(a) % B(W) as used above and throughout this Management's Analysis means % Better (Worse).
(b) Exclusive of facility actions net loss and unusual charges.

Year 2000

We have established an enterprise-wide program to prepare our computer systems and applications for the Year 2000. We are utilizing both internal and external resources to identify, correct and test the systems for Year 2000 issues. We anticipate that the majority of domestic reprogramming will be complete by December 1998, and testing efforts will be concluded in the first quarter of 1999. TRICON Restaurants International has initiated a program to assess and correct computer systems for the Year 2000 in five major international markets. We intend to distribute this program to all other international markets in early 1998. We anticipate that business-critical international systems will be reprogrammed and tested by June 1999.

Because third party failures could have a material impact on our ability to conduct business, confirmations are being requested from our processing vendors and suppliers to certify that plans are being developed to address the Year 2000 issues. An assessment of our franchisee readiness is also in process. We anticipate that in the second quarter of 1998, information will be provided to all franchisees regarding the potential business risks associated with the Year 2000 issues.

Testing and conversion of systems and applications is expected to cost $40-$45 million from 1997 through 1999. Of these costs, approximately $4 million had been incurred by year-end 1997 and approximately $35 million is expected to be incurred in 1998. All costs are expected to be funded by cash flows from operations.

Though the benefits of the fourth quarter unusual charge, discussed below, are expected to be significant, we expect that they will be offset in the near term by the negative impact of fluctuations in Asian currencies and incremental spending related to Year 2000 issues.

Other Factors Affecting Comparability

In addition to the above identified near-term risks in our Asian businesses and costs related to Year 2000 issues, we believe that certain items included in 1997 results of operations are either unlikely to recur in 1998 or are expected to recur in significantly different magnitudes, thereby affecting future comparability of results. These items, more fully described in the appropriate sections of Management's Analysis, include the $24 million in special KFC franchise contract renewal fees primarily from renewals in the first half of 1997 which will not recur in 1998. In addition, 1998 total facility actions after-tax net gain is expected to be approximately half of the level of the after-tax net gain recognized in 1997, excluding the fourth quarter charge, due to the inclusion in the second quarter of 1997 of the tax-free gain of $100 million related to the refranchising of our restaurants in New Zealand through an initial public offering. During 1997, the non-core businesses, defined below, generated approximately $10 million ($8 million after-tax) of income before unusual charges through their dates of disposal in 1997 which will not recur.

As more fully discussed in Notes 3 and 16, we believe that our ongoing corporate unallocated annual general and administrative expenses as an independent, publicly owned entity will exceed the annualized amount of the PepsiCo allocation by approximately $20 million. This expected increase will be partially offset by non-recurring TRICON start-up costs of approximately

$14 million which were incurred in the last three quarters of 1997. Our net interest expense is expected to be $40 million to $50 million higher in 1998, driven by the higher outstanding debt levels and higher expected weighted average interest rates. The increased general and administrative and interest expenses will primarily be incurred over the first three quarters of 1998.

Subsequent to year-end, we agreed to sell our shared services facility in Wichita, Kansas. We will relocate most of our Wichita operations to Dallas, Texas, and Louisville, Kentucky. Although we anticipate a gain on the sale when the transaction closes, currently scheduled for the fourth quarter of 1998, the majority of the relocation and other costs related to the decision will be incurred in earlier quarters of 1998. The full year net impact of the sale and relocation is expected to be immaterial.

Store Portfolio Perspectives

In the fourth quarter, we announced a $530 million unusual charge ($425 million after-tax). See Note 4. The charge included (1) costs of closing underperforming stores during 1998, primarily at Pizza Hut and internationally; (2) reduction to fair market value, less costs to sell, of the carrying amounts of restaurants we intend to refranchise in 1998; (3) impairment of certain restaurants intended to be used in the business; (4) impairment of certain joint venture investments; and (5) related personnel reductions. The components of the charge were as follows:

Store closure costs	$213
Refranchising losses	136
Impairment charges for stores to be used in the business	61
Total facility actions net loss	410
Impairment of investment in unconsolidated affiliates	79
Severance and other	41
Total unusual charges	120
Total fourth quarter charges	$530

The charge is largely non-cash and is expected to have a favorable impact on future cash flows and operating profits. We believe our worldwide business, upon completion of the actions covered by the charge, will be significantly more focused and better positioned to deliver consistent growth in operating earnings before facility actions.

For more than two years, we have been working to reduce our share of total system units by selling Company restaurants to existing and new franchisees where their expertise can be leveraged to improve our concepts' overall operational performance, while retaining Company ownership of key markets. This portfolio-balancing activity has, and will continue to, reduce our reported revenues and increase the importance of system sales as a key performance measure. Refranchising frees up invested capital while continuing to generate franchise fees, thereby improving returns. We have also actively closed underperforming units. Restaurant margins and cash flows benefit from the one-time impact of refranchising gains and the ongoing impact of closing underperforming Company units. The impact of refranchising gains is expected to decrease over time.

As a result of our initiatives, coupled with new points of distribution added by our franchisees and licensees, our overall Company percentage (including joint venture units) of our Core Businesses' total system units declined by 6 percentage points from 44% at year-end 1996 to 38% at year-end 1997. We refranchised 1,418 and 659 Company units in 1997 and 1996, respectively. In addition, we closed 661 and 352 Company units in 1997 and 1996, respectively, and have approved for closure an additional 697 units at year-end 1997. Total system units grew 2% and 4% in 1997 and 1996, respectively, driven by new points of distribution added by our franchisees and licensees. As we approach a Company/franchise balance more consistent with our major competition, refranchising activity is expected to substantially decrease.

Results of Operations

Comparability

On an overall basis, we lost $111 million in 1997 or $.73 per basic share. In the context of our Spin-off, comparisons of results of operations for the year are complex. The fourth quarter charge and the significant level of other facility actions, including the second quarter refranchising through an initial public offering of our restaurants in New Zealand, represent significant items which complicate year-over-year comparisons. In addition, the disposal of our non-core businesses in 1997 adds complexity.

Our historical financial statements are also impacted by our lack of history as an independent, publicly owned company. Therefore, the amounts for certain items such as general and administrative expenses, interest expense and income taxes, included in our historical reported results for periods prior to the Spin-off, represent allocations or computations which are not indicative of the results of operations, financial position and cash flows as if we had been an independent, publicly owned company during all periods presented. See Notes 2, 3, 4 and 16. In addition, the separation agreement entered into in connection with the Spin-off specifies that PepsiCo shall make a final

determination regarding the net assets of the restaurant businesses transferred to us at the Spin-off Date. This determination has been preliminarily completed, but is subject to our agreement. The accompanying Consolidated Financial Statements reflect our estimates, based on available information, of the net assets that should be transferred. The final approved determination could vary from these estimates. Any changes are not expected to materially affect future net income.

Additionally, comparative information is impacted by the operations of and disposal charges related to our non-core restaurant businesses. These disposal charges included an estimated provision for all expected future liabilities associated with the disposal of the non-core businesses which we were required to retain as part of the Spin-off. Actual amounts incurred may ultimately differ from these estimates. California Pizza Kitchen, Chevys Mexican Restaurant, D'Angelo Sandwich Shop, East Side Mario's and Hot 'n Now (collectively, the "Non-core Businesses") were sold prior to the Spin-off Date.

Following is a summary of the impacts on our operating results of the operations and disposal of the Non-core Businesses:

	1997	1996	1995
Revenues	**$268**	$ 394	$ 297
% of total revenues	**3%**	4%	3%
Non-core Businesses operating profit (loss), excluding disposal and impairment charges	**13**	(10)	(42)
Impairment charges			120
Unusual disposal charges	**54**	246	
Net loss	**$ (26)**	$(200)	$(116)

The impact of the operations and sale of the Non-core Businesses is more fully discussed in Note 16. To facilitate comparability of future operating results, the following analysis of historical results of operations concentrates on Core Businesses only except where specifically noted.

Worldwide — Core Business Only

	1997				
	Total	Adjusted[1]	% B(W) vs. 1996[2]	1996	% B(W) vs. 1995
System Sales	**$20,465**		1	$20,280	3
Revenues					
Company sales	**$ 8,846**		(5)	$ 9,347	(2)
Franchise and license fees	**567**		15	491	13
Total Revenues	**$ 9,413**		(4)	$ 9,838	(1)
Company Restaurant Margin					
Domestic	**$ 777**		3	$ 756	(10)
International	**242**		2	237	8
Total	**$ 1,019**		3	$ 993	(7)
% of sales	**11.5%**		.9 points	10.6%	(.6 points)
Operating Profit					
Ongoing operating profit	**$ 649**	**$ 649**	10	$ 591	(15)
Facility actions net (loss) gain	**(247)**	**163**	NM	37	NM
Unusual charges	**(120)**		NM		NM
Operating profit	**282**	**812**	29	628	52
Interest & Income Taxes					
Interest expense, net	**273**	**273**	7	295	16
Income tax provision	**94**	**199**	(7)	186	NM
Net (Loss) Income	**$ (85)**	**$ 340**	$193	$ 147	$163
Pro forma (loss) earnings per basic share	**$ (.56)**	**$ 2.24**	NM	$ .97	NM

(1) Excluding the effects of the fourth quarter charge.
(2) Computed based on adjusted amounts, if applicable.
NM - Not Meaningful

Worldwide Restaurant Unit Activity

	Company	Joint Venture	Franchised	Licensed	Total
Balance at Dec. 30, 1995	12,540	926	11,901	2,527	27,894
New Builds & Acquisitions	342	86	779	1,039	2,246
Refranchising & Licensing	(659)		640	19	-
Closures	(347)	(5)	(254)	(438)	(1,044)
Balance at Dec. 28, 1996	11,876	1,007	13,066	3,147	29,096
New Builds & Acquisitions	280	123	972	731	2,106
Refranchising & Licensing	(1,407)	(11)	1,410	8	-
Closures	(632)	(29)	(351)	(478)	(1,490)
Balance at Dec. 27, 1997	10,117[a]	1,090	15,097	3,408	29,712

(a) Includes 697 units approved for closure but not yet closed at December 27, 1997.

System sales, which represents the combined sales of the Company, joint venture, franchised and licensed units, increased $185 million or 1% in 1997. Excluding the negative impact of foreign currency translation, system sales increased by $525 million or 3%. The increase before the effects of foreign currency translation reflected the development of new units, primarily by franchisees and licensees. Domestic development was primarily at Taco Bell and international development was primarily in Asia. This growth in system sales was partially offset by store closures. The 1996 increase of $548 million or 3% in system sales related to new unit growth in franchised and licensed operations and new Company units, primarily in international markets. The overall system sales growth was partially offset by store closures.

Revenues decreased $425 million or 4% in 1997. Company sales decreased $501 million or 5% in 1997. The decrease was driven primarily by fewer Company units as a result of our refranchising initiatives and store closures. This decline was partially offset by higher effective net pricing. Franchise and license fees increased $76 million or 15% in 1997, primarily due to an increased number of franchised units, an increase in continuing fees related to our refranchising activities and renewal fees received under a special KFC U.S. franchise contract renewal. This increase in franchise and license fees was partially offset by the unfavorable effects of foreign currency translation.

Total revenues decreased $114 million or 1% in 1996, primarily attributable to a decline of $172 million, or 2%, in Company sales, partially offset by a 13% increase in franchise and license fees. The decrease in Company sales was driven by volume declines, partially due to lapping the strong volume increases in 1995 resulting from the successful introduction of Stuffed Crust Pizza by Pizza Hut in the U.S. The decline also reflects the unfavorable impact of fewer U.S. Company units in 1996 as compared to 1995 as a result of our refranchising initiatives and store closures. These declines were partially offset by higher effective net pricing, improved same store sales at KFC in the domestic market and new Company units, primarily in international markets. The increase in franchise and license fees in 1996 primarily reflected new franchise and license units and the continuing franchise fees from refranchised restaurants.

Restaurant Margin–Worldwide

	1997	1996	1995
Company sales	**100.0%**	100.0%	100.0%
Food and paper	**32.4**	33.1	33.0
Payroll and employee benefits	**28.5**	28.5	28.2
Occupancy and other operating expenses	**27.6**	27.8	27.6
Restaurant margin	**11.5%**	10.6%	11.2%

Company restaurant margins as a percent of sales increased 90 basis points for 1997. The increase in restaurant margin in 1997 was partially driven by effective net pricing in excess of increased costs, primarily labor. The other primary factor impacting margin was the positive impact of refranchising and closing underperforming units which contributed about 60 basis points of the improvement. This margin increase was partially offset by lower overall transactions. 1997 also benefited from lower commodity costs primarily related to favorable cheese and chicken prices.

Company restaurant margins decreased in 1996, primarily attributable to increased costs, primarily labor. In addition, lower volumes contributed to the decline in margin. These decreases were partially offset by higher effective net pricing, reduced depreciation and amortization relating to the impairment charges previously taken and the positive impact of refranchising and closing underperforming units.

General, Administrative and Other Expenses

	1997	% B(W) vs. 1996	1996	% B(W) vs. 1995
Domestic	**$556**	(1)	$548	(10)
International	**289**	(6)	273	(7)
Unallocated	**92**	(30)	71	(45)
	$937	(5)	$892	(11)

General, administrative and other expenses ("G&A") includes general and administrative expenses, other income and expense, equity income or loss from investments in unconsolidated affiliates and foreign exchange gains and losses.

Included in the unallocated G&A is a PepsiCo allocation amount of $37 million, $53 million and $52 million in 1997 (through the Spin-off Date), 1996 and 1995, respectively, reflecting a portion of PepsiCo's shared administrative expenses. The amounts of PepsiCo's administrative expenses allocated to us by PepsiCo were based on PepsiCo's total corporate administrative expenses using the ratio of our revenues to PepsiCo's revenues. We believe that this basis of allocation was reasonable based on the facts available at the date of such allocation. Based on our current analysis, we also believe that the G&A expenses we would have incurred as an independent, publicly owned company would have been approximately $20 million higher than the annualized allocation from PepsiCo.

The $45 million or 5% increase in G&A in 1997 reflected increased investment spending, TRICON start-up costs, higher incentive compensation, increased litigation-related costs and higher foreign exchange losses. Investment spending consisted primarily of costs related to improving and updating administrative systems, including initial spending on Year 2000 issues, as well as investments during 1997 in certain key international markets. These higher expenses were partially offset by the lapping of a reorganization charge that Pizza Hut took in 1996, overall lower project spending and field overhead, particularly at Pizza Hut, and the favorable impact of divested units.

The $89 million or 11% increase in G&A in 1996 reflected increased spending, led by multiple U.S. initiatives to improve customer service and to support growth in our principal international markets. Customer service initiatives included expanding the number and training of personnel supervising the restaurant managers, as well as project spending against market-related programs.

Facility Actions Net Loss (Gain)

	1997 Total	1997 Excluding 4th Quarter Charge	1996	1995
Refranchising gains, net	**$(112)**	**$(248)**	$(139)	$ (93)
Store closure costs	**248**	**35**	40	38
Impairment charges for stores to be used in the business	**111**	**50**	62	337
Facility actions net loss (gain)	**$ 247**	**$(163)**	$ (37)	$282

Refranchising gains, which included initial franchise fees of $41 million, $22 million and $8 million in 1997, 1996 and 1995, respectively, as well as a $100 million tax-free gain from refranchising our restaurants in New Zealand through an initial public offering, arose from the refranchising of 1,418, 659 and 264 units in 1997, 1996 and 1995, respectively.

Store closure costs are provided upon management's decision to close a unit. These costs included the estimated cost of closing an additional 697 units approved for closure in 1997, which were not yet closed at December 27, 1997. We closed 661, 352 and 267 units in 1997, 1996 and 1995, respectively.

Impairment charges in 1997 of $50 million and in 1996 of $62 million resulted from our semi-annual impairment evaluations of each restaurant which will continue to be used in the business that initially met our "two-year history of operating losses" primary impairment indicator or due to other changes in circumstances. The $337 million charge in 1995 was related to the initial adoption of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS 121"), which we believe requires periodic impairment evaluations at the restaurant level. Previously, impairment was evaluated and measured if a restaurant concept was incurring operating losses and was expected to incur operating losses in the future.

Operating Profits

	1997	% B(W) vs. 1996	1996	% B(W) vs. 1995
Domestic	**$605**	17	$516	(17)
International	**170**	13	151	26
Foreign exchange losses	**(16)**	NM	(5)	NM
Unallocated expenses	**(110)**	(55)	(71)	(45)
Ongoing operating profit	**$649**	10	$591	(15)

NM - Not Meaningful

Exclusive of the fourth quarter charge and other facility actions, operating profits increased $58 million or 10% in 1997. Excluding the negative impact of unfavorable currency translation, the increase in operating profit was $67 million or 11%. This increase in 1997 relates primarily to higher franchise fees and improved restaurant margins, partially offset by an increase in unallocated expenses primarily reflecting an increase in general, administrative and other expenses.

Operating profits, exclusive of facility actions, decreased $103 million or 15% in 1996. The decrease in 1996 is due primarily to an increase in general, administrative and other expenses and a decline in restaurant margins, partially offset by higher franchise fees.

Interest Expense, Net

Prior to the Spin-off, our operations were financed through operating cash flows, refranchising activities and investments by and advances from PepsiCo. At the Spin-off Date, a bank credit agreement replaced the financing previously provided by PepsiCo and, additionally, funded a dividend to PepsiCo. See Notes 3 and 9. Our interest expense includes an allocation by PepsiCo of its interest expense (PepsiCo's weighted average interest rate applied to the average balance of investments by and advances from PepsiCo) and interest on our external debt for all periods prior to the Spin-off. We believe such allocated interest expense is not indicative of the interest expense that we would have incurred as an independent, publicly owned company or will incur in future periods. See Note 16. Subsequent to the Spin-off Date, our interest cost consists primarily of interest expense related to our bank credit agreement and interest on other third party debt, including capital leases, most of which existed at the Spin-off Date.

Interest expense decreased in 1997, primarily due to the lower outstanding amount of PepsiCo-provided financing. Such impact is partially offset by the higher interest rate on our bank credit agreement, as compared to the PepsiCo rate used in the allocation process, and also higher outstanding debt levels.

Interest expense decreased in 1996 primarily due to the lower outstanding amount of PepsiCo-provided financing and a lower weighted average interest rate than in 1995.

Income Taxes

For periods prior to the Spin-off, income tax expense was calculated, to the extent possible, as if we filed income tax returns separate from PepsiCo. As PepsiCo managed its tax position on a consolidated basis, which takes into account the results of all its businesses, our effective tax rate in the future could vary significantly from our calculated historical effective tax rates. Our future effective tax rate will largely depend on our structure and tax strategies as an independent, publicly owned company.

Income Taxes and Effective Tax Rate

	1997	1996	1995
Core Business Actual			
Income taxes	**$ 94**	$186	$ 77
Effective tax rate	**NM**	55.9%	NM
Ongoing*			
Income taxes	**$205**	$186	$170
Effective tax rate	**46.7%**	55.9%	45.1%

*Adjusted to exclude the effects of the 1997 fourth quarter charge, the 1997 $100 million tax-free gain associated with the New Zealand initial public offering and the initial impact of adopting SFAS 121 in 1995. See Note 4.
NM - Not Meaningful

The following reconciles the U.S. Federal statutory tax rate to our ongoing effective rate:

	1997	1996	1995
U.S. Federal statutory tax rate	**35.0%**	35.0%	35.0%
State income tax, net of Federal tax benefit	**4.5**	2.6	2.3
Foreign and U.S. tax effects attributable to foreign operations	**5.5**	16.3	6.6
Other, net	**1.7**	2.0	1.2
Ongoing effective tax rate	**46.7%**	55.9%	45.1%

The 1997 ongoing effective tax rate decreased 9.2 points to 46.7%. The decrease in the 1997 ongoing effective tax rate was primarily due to the decrease in taxes attributable to foreign operations, partially offset by an increase in state taxes. The foreign decrease was due to the absence of the adjustment recorded in 1996 to establish a valuation allowance, which is more fully described below, as well as a decrease in adjustments related to prior tax years. The increase in state tax was primarily due to an increase in adjustments related to prior tax years.

The increase in the 1996 ongoing effective tax rate related to an increase in taxes attributable to foreign operations, due in part to adjustments related to prior tax years, and the establishment of a valuation allowance due to a change in judgment as to the expected realization of certain foreign deferred tax assets resulting from a larger than expected net operating loss during 1996 and forecasted continuing operating losses for the next several years in a foreign jurisdiction.

The effective tax rate attributable to foreign operations varied from year-to-year but in each year was higher than the U.S. Federal statutory tax rate. This was primarily due to foreign tax rate differentials, including foreign withholding tax paid without benefit of the related foreign tax credit for U.S. income tax purposes and losses of foreign operations for which no tax benefit could be currently recognized.

Earnings (Loss) Per Share

The components of basic earnings (loss) per share would have been as follows:

	1997	1996	1995
Core Businesses operating earnings	**$1.34**	$ .83	$1.29
Fourth quarter charge	**(2.80)**		
Other facility actions net gain (loss)	**.90**	.14	(1.40)
Core Businesses net (loss) earnings per share	**(.56)**	.97	(.11)
Non-core Businesses operating earnings (loss)	**.05**	(.08)	(.22)
Non-core Businesses facility actions net loss and unusual charges	**(.22)**	(1.24)	(.54)
Net loss per share	**$ (.73)**	$(.35)	$(.87)

Domestic — Core Business Only

	1997		1996	
	Amount	**% B(W) vs. 1996**	Amount	% B(W) vs. 1995
System Sales	**$13,502**	**1**	$13,388	1
Revenues				
Company sales	**$ 6,728**	**(7)**	$ 7,224	(5)
Franchise and license fees	**367**	**20**	306	15
Total Revenues	**$ 7,095**	**(6)**	$ 7,530	(4)
Company Restaurant Margin	**$ 777**	**3**	$ 756	(10)
% of sales	**11.6%**	**1.1 points**	10.5%	(.6 points)

U.S. Restaurant Unit Activity

	Company	Franchised	Licensed	Total
Balance at Dec. 30, 1995	10,087	7,484	2,340	19,911
New Builds & Acquisitions	185	263	966	1,414
Refranchising & Licensing	(609)	598	11	-
Closures	(267)	(108)	(414)	(789)
Balance at Dec. 28, 1996	9,396	8,237	2,903	20,536
New Builds & Acquisitions	141	324	731	1,196
Refranchising & Licensing	(1,199)	1,191	8	-
Closures	(516)	(155)	(475)	(1,146)
Balance at Dec. 27, 1997	7,822[a]	9,597	3,167	20,586

(a) Includes 540 units approved for closure, but not yet closed at December 27, 1997.

System sales increased $114 million or 1% in 1997 primarily reflecting higher volumes from new unit activity, principally by franchisees and licensees at Taco Bell, partially offset by closure of underperforming units.

The 1996 increase of $189 million or 1% in system sales primarily related to new unit growth in franchised and licensed operations. The overall system sales growth was reduced by store closures.

Revenues decreased $435 million or 6% in 1997 primarily due to Company sales decreases of $496 million or 7%. The decrease was driven primarily by fewer Company units, primarily at Pizza Hut and Taco Bell, as a result of our refranchising initiative and store closures. The decline was partially offset by higher overall effective net pricing. This pricing impact occurred primarily at Taco Bell, which exceeded lower prices at Pizza Hut.

Franchise and license fees increased $61 million or 20% in 1997 primarily due to an increase in continuing fees related to our refranchising activities and new unit development at Pizza Hut and Taco Bell and to renewal fees of $24 million under a special KFC franchise contract renewal. Substantially all of KFC's franchisees renewed their franchise agreements, typically for 20 years, during 1997. As part of the special renewal program at KFC, certain participating franchisees also committed to attain over the next several years certain facility standards based on physical assessment of that franchisee's restaurants. We believe such upgrades of the franchised facilities will ultimately result in higher system sales and, therefore, higher franchise fees.

Same store sales are measured for our U.S. Company units. Same store sales at KFC increased 2% in 1997 driven by product promotions, favorable effective net pricing and increased delivery sales, partially offset by lower transaction counts. Same store sales at Pizza Hut decreased 1% for 1997, rebounding from a 7% decline through the second quarter. At Pizza Hut, lower average guest checks in 1997 and decreasing transaction counts in the first half of the year were partially offset in the second half by quality initiatives, increasing transaction counts and the introduction of "The Edge" Pizza. Taco Bell same store sales increased 2% in 1997 reflecting the successful Star Wars and Batman promotions, favorable product mix shifts and pricing, offset by lower transaction counts.

Total 1996 revenues decreased $335 million or 4% primarily due to Company sales decreases of $374 million or 5%. The decrease was driven by volume declines, partially due to lapping the second quarter 1995 introduction of Stuffed Crust Pizza, and the unfavorable impact of fewer Company units due to refranchisings and closures. These declines were partially offset by higher effective net pricing. Same store sales decreased 4% and 2% in 1996 at Pizza Hut and Taco Bell, respectively, reflecting lower transaction counts. KFC's same store sales increased 6% in 1996 due primarily to the impact of new products such as Tender Roast Chicken, Colonel's Crispy Strips and Chunky Chicken Pot Pies.

Franchise and license fees increased $39 million or 15% in 1996 due primarily to an increase in the number of franchised and licensed units from new unit development, primarily at Taco Bell, and our refranchising activities.

Restaurant Margin–Domestic

	1997	1996	1995
Company sales	**100.0%**	100.0%	100.0%
Food and paper	**31.1**	32.1	32.3
Payroll and employee benefits	**30.3**	30.0	29.5
Occupancy and other operating expenses	**27.0**	27.4	27.1
Restaurant margin	**11.6%**	10.5%	11.1%

The increase in margin of 110 basis points in 1997 was driven almost equally by effective net pricing in excess of increased costs, primarily labor, and the positive impact of closing and refranchising lower-margin units at Pizza Hut and Taco Bell. This improvement was partially offset by the effect of reduced transaction counts. The increased labor costs were due to the increased minimum wage in the U.S. and to costs incurred to improve customer satisfaction, partially offset by favorable actuarial adjustments to workers' compensation liabilities. In 1997, we also benefited from lower commodity costs primarily related to favorable cheese and chicken prices.

The margin decrease in 1996 was attributable to increased costs, primarily labor, and lower volumes. These impacts were partially offset by higher effective net pricing, reduced depreciation and amortization relating to the SFAS 121 charges previously taken and the positive impact of refranchising and closing underperforming units.

Operating profits for domestic operations, exclusive of the fourth quarter charge and other facility actions, were $605 million, $516 million and $624 million for 1997, 1996 and 1995, respectively. The increase of $89 million or 17% in 1997 was due primarily to higher franchise fees and improved restaurant margins, partially offset by an increase in general, administrative and other expenses.

The decrease in 1996 of $108 million or 17% was due to a decrease in restaurant margins and an increase in general, administrative and other expenses.

International — Core Business Only

	1997		1996	
	Amount	**% B(W) vs. 1996**	Amount	% B(W) vs. 1995
System Sales	**$6,963**	**1**	$6,892	6
Revenues				
Company sales	**$2,118**	*****	$2,123	11
Franchise and license fees	**200**	**8**	185	11
Total Revenues	**$2,318**	*****	$2,308	11
Company Restaurant Margin	**$ 242**	**2**	$ 237	8
% of sales	**11.4%**	**.2 points**	11.2%	(.3 points)

*Less than 1%.

International Restaurant Unit Activity

	Company	Joint Venture	Franchised	Licensed	Total
Balance at Dec. 30, 1995	2,453	926	4,417	187	7,983
New Builds & Acquisitions	157	86	516	73	832
Refranchising & Licensing	(50)		42	8	-
Closures	(80)	(5)	(146)	(24)	(255)
Balance at Dec. 28, 1996	2,480	1,007	4,829	244	8,560
New Builds & Acquisitions	139	123	648		910
Refranchising & Licensing	(208)	(11)	219		-
Closures	(116)	(29)	(196)	(3)	(344)
Balance at Dec. 27, 1997	2,295[(a)]	1,090	5,500	241	9,126

(a) Includes 157 units approved for closure, but not yet closed at December 27, 1997.

System sales increased $71 million or 1% in 1997. Exclusive of the negative impact of foreign currency translation, system sales increased $411 million or 6% in 1997. This growth was driven by new unit development, partially offset by store closures. Franchisee activity drove system unit development with approximately 50% of that activity occurring in Asia. The increase of $359 million in 1996 primarily represented new unit growth by franchisees.

Revenues increased $10 million or less than 1% in 1997. Exclusive of the negative impact of foreign currency translation, revenues increased $86 million or 4%. This increase relates primarily to higher effective net pricing, new unit development in Asia and an increase in franchise fees attributable to development offset by store closures. Company sales in 1997 decreased $5 million or less than 1%. Exclusive of the negative impact of foreign currency translation, company sales increased $66 million or 3%. This increase was driven primarily by higher effective net pricing and unit development, partially offset by the effect of refranchising our restaurants in New Zealand through an initial public offering in the second quarter. Franchise and license fees increased $15 million or 8% in 1997 primarily from new unit development and restaurants refranchised in New Zealand and Canada.

Revenues increased $221 million or 11% in 1996. Increases in Company sales of $202 million or 11% were driven by the favorable impact of additional Company units, higher effective net pricing and increased volumes. The increase in franchise and license revenue of $19 million or 11% in 1996 primarily reflected new unit development.

Restaurant Margin–International

	1997	1996	1995
Company sales	**100.0%**	100.0%	100.0%
Food and paper	**36.5**	36.3	35.7
Payroll and employee benefits	**22.7**	23.2	23.3
Occupancy and other operating expenses	**29.4**	29.3	29.5
Restaurant margin	**11.4%**	11.2%	11.5%

The improvement in margin in 1997 was primarily due to effective net pricing in excess of cost increases, primarily labor, offset by volume declines. Foreign currency translation and portfolio activity did not have a significant impact on restaurant margin. The 30 basis point decrease in 1996 over 1995 reflected increases in variable costs partially offset by effective net pricing and the reduced depreciation and amortization relating to SFAS 121 charges previously taken.

Operating profits, exclusive of the fourth quarter charge and other facility actions, were $170 million, $151 million and $120 million for 1997, 1996 and 1995, respectively. The increase of $19 million or 13% in 1997 was primarily driven by new units, higher restaurant margins and increased franchise fees, partially offset by an increase in general, administrative and other expenses and the unfavorable effect of currency translation. Exclusive of the unfavorable effect of currency translation, the increase in 1997 operating profit was $28 million or 19%.

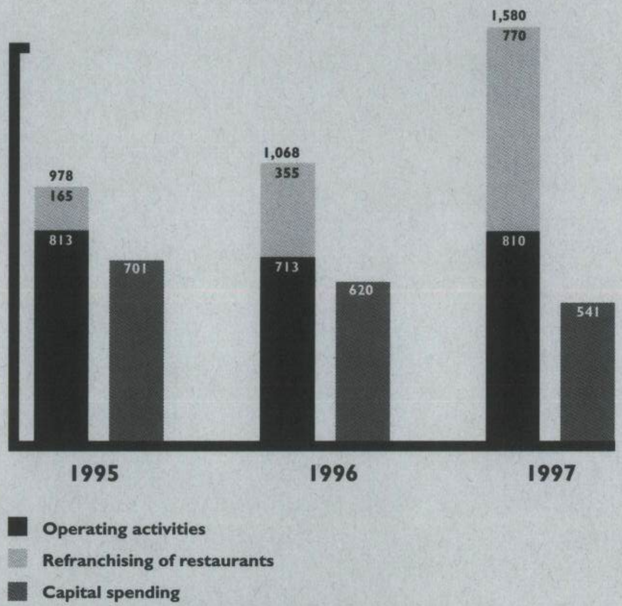
The increase in 1996 of $31 million or 26% reflected net additional Company units, increased volumes and reduced depreciation and amortization relating to the SFAS 121 charges previously taken, partially offset by an increase in general, administrative and other expenses and restaurant margin declines.

Consolidated Cash Flows

(Including Core and Non-core Businesses)

Net cash provided by operating activities and refranchising of restaurants vs. capital spending

(in millions)



Net cash provided by operating activities increased $97 million or 14% to $810 million in 1997. This was driven by an increase in net income prior to facility actions net loss and unusual charges recorded in 1997 and an increase in our normal working capital deficit primarily related to higher income tax payables. These increases were partially offset by reduced depreciation and amortization in 1997. The decrease in depreciation and amortization related to refranchisings and store closures and to lower asset costs due to impairment charges.

Net cash provided by operating activities in 1996 decreased $100 million or 12% to $713 million. The decrease was due to reduced income before non-cash charges and credits of $76 million and a $24 million decline in our working capital deficit. The decline in our working capital deficit was primarily due to an unfavorable swing in income taxes payable, partially offset by faster growth in accounts payable and other current liabilities and a favorable swing in inventories. The change in accounts payable and other current liabilities was primarily due to timing of payments.

Net cash provided by investing activities increased $715 million to $466 million in 1997 compared to net cash used for investing activities of $249 million and $597 million in 1996 and 1995, respectively. The 1997 increase was primarily attributable to an increase in proceeds from refranchising of restaurants of $415 million over 1996 and the proceeds from the sale of the Non-core Businesses of $186 million. Capital spending decreased by $79 million or 13%. The decline in net cash used for investing activities in 1996 of $348 million or 58% related to an increase in the proceeds from refranchising activities of $190 million and a reduction in capital spending of $81 million in 1996, which reflected a slowdown of new unit development as part of our initiative to reduce our percentage ownership of total system units.

Net cash used for financing activities more than doubled in 1997 to $1.1 billion, primarily reflecting the net payments to PepsiCo, partially offset by the bank borrowings in connection with the Spin-off. This net use was partially offset by the increase in short-term borrowings of $83 million in 1997 versus a decrease of $80 million in 1996 and payments on the Revolving Credit Facility.

Net cash used for financing activities in 1996 nearly doubled to $422 million primarily reflecting debt payments in 1996 compared to proceeds in 1995 and net cash payments to PepsiCo.

Financing Activities

Our initial debt funding was a $5.25 billion bank credit agreement comprised of a $2 billion senior, unsecured Term Loan Facility and a $3.25 billion senior, unsecured Revolving Credit Facility which mature on October 2, 2002. Interest is based principally on the London Interbank Offered Rate ("LIBOR") plus a variable margin as defined in the credit agreement. As of December 27, 1997, $1.97 billion and $2.44 billion were outstanding on the Term Loan and Revolving Credit Facility, respectively, and we had $692 million in unused revolving credit capacity, net of Letters of Credit of $123 million. The credit facilities are subject to various affirmative and negative covenants including financial covenants as well as limitations on additional indebtedness including guarantees of indebtedness, cash dividends, aggregate non-U.S. investments, among other things, as defined in the credit agreement.

This substantial indebtedness subjects us to significant interest expense and principal repayment obligations which are limited, in the near term, to prepayment events as defined in the credit agreement. Our highly leveraged capital structure could also adversely affect our ability to obtain additional financing in the future or to undertake refinancings on terms and subject to conditions that are acceptable to us.

At year-end 1997, we were in compliance with the above noted covenants, and we will continue to closely monitor on an ongoing basis the various operating issues that could, in aggregate, affect our ability to comply with financial covenant requirements. Such issues include the ongoing economic issues faced by much of Asia as well as the intensely competitive nature of the QSR industry.

A key component of our financing philosophy is to build balance sheet liquidity and to diversify sources of funding. Consistent with that philosophy, which was discussed with our lenders during syndication of the Term Loan Facility and Revolving Credit Facility, we have taken steps to refinance a portion of our existing bank credit facility. In that regard, in 1997 we filed with the Securities and Exchange Commission a shelf registration statement on Form S-3 with respect to an offering of $2 billion of senior unsecured debt. We may offer and sell from time to time, debt securities in one or more series, in amounts, at prices and on terms to be determined by market conditions at the time of sale, as discussed in more detail in the registration statement. We currently intend to use the net proceeds from an expected issuance and sale of debt securities offered under this shelf registration to reduce term debt under the above-referenced bank credit agreement and for general corporate purposes. During 1998, we intend to reduce our reliance on bank debt by up to $1 billion through a combination of proceeds from the debt securities offered under this shelf registration, proceeds from refranchising activities and a reduction in unused credit facilities.

We use various derivative instruments with the objective of reducing volatility in our borrowing costs. We have utilized interest rate swap agreements to effectively convert a portion of our variable rate (LIBOR) bank debt to fixed rate. Subsequent to year-end 1997, we have entered into treasury lock agreements to partially hedge the anticipated issuance of our senior debt securities discussed above. We have also entered into an interest rate arrangement to limit the range of interest rates on a portion of our variable rate bank debt. Other derivative instruments may be considered from time to time as well to manage our debt portfolio and to hedge foreign currency exchange exposures.

We believe that cash flows from our ongoing refranchising initiatives and our operating activities will be sufficient to support our capital spending and to service our debt.

Consolidated Financial Condition

(Including Core and Non-core Businesses)

Assets decreased $1.4 billion or 22% to $5.1 billion at year-end 1997. The decline was principally due to the fourth quarter charge, refranchising and store closures and the disposal of the Non-core Businesses, partially offset by an increase in cash.

Liabilities increased $4.4 billion to $6.7 billion at year-end 1997 primarily reflecting the $4.55 billion borrowing under our bank credit agreement, partially offset by a lower net deferred tax liability. The lower net deferred tax liability results primarily from the higher deferred tax assets principally related to the fourth quarter charge.

Our operating working capital deficit, which excludes short-term investments, short-term borrowings and non-core assets held for disposal, is typical of restaurant operations where the majority of sales are for cash. The modest $27 million increase in our operating working capital deficit to $805 million at year-end 1997 primarily reflected an increase in current liabilities related to the fourth quarter charge.

Quantitative and Qualitative Disclosures About Market Risk

Derivative Instruments

Our policy prohibits the use of derivative instruments for trading purposes and we have procedures in place to monitor and control their use. Our current use of derivative instruments is primarily limited to interest rate swaps and commodity futures contracts.

Interest rate swaps are entered into with the objective of converting variable to fixed rate debt, thereby reducing volatility in borrowing costs. In 1997, we entered into interest rate swaps to effectively convert a portion of our variable rate bank debt to fixed rate. Payment dates and the floating rates on the swaps match those of the underlying bank debt. Our credit risk related to interest rate swaps is dependent upon both the movement in interest rates and the possibility of non-payment by swap counterparties. We mitigate credit risk by only entering into the swap agreements with high credit-quality counterparties and netting swap payments within each contract.

Commodity futures contracts traded on national exchanges are entered into with the objective of reducing food costs. While this hedging activity has historically been limited, hedging activity could increase in the future if we believe it would result in lower total costs. Open contracts, deferred gains and losses and realized gains and losses were not significant for all years presented.

Market Risk

Our primary market risk exposure with regard to financial instruments is to changes in interest rates, principally in the United States. In addition, a portion of our debt is denominated in foreign currencies which exposes us to market risk associated with exchange rate movements. Historically, we have not used derivative financial instruments to manage our exposure to foreign currency rate fluctuations since the market risk associated with our foreign currency denominated debt was not considered significant.

At December 27, 1997, a hypothetical 100 basis point increase in short-term interest rates would result in a reduction of $33 million in annual pre-tax earnings. The estimated reduction is based upon the unhedged portion of our variable rate debt and assumes no change in the volume or composition of debt at December 27, 1997. In addition, the fair value of our interest rate derivative contracts would increase approximately $25 million. Fair value was determined by discounting the projected interest rate swap cash flows.

Cautionary Statements

From time to time, in both written reports and oral statements, we present "forward-looking statements" within the meaning of Federal and state securities laws, including those identified by such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These "forward-looking statements" reflect our current expectations and are based upon data available at the time of the statements. Actual results involve risks and uncertainties, including both those specific to the Company and those specific to the industry, and could differ materially from expectations.

Company risks and uncertainties include but are not limited to the lack of experience of our management group in operating the Company as an independent, publicly owned business; potentially substantial tax contingencies related to the Spin-off, which, if they occur, require us to indemnify PepsiCo; our substantial debt leverage and the attendant potential restriction on our ability to borrow in the future, as well as the substantial interest expense and principal repayment obligations; potential unfavorable variances between estimated and actual liabilities both as contained in the PepsiCo-prepared balance sheet for the restaurant businesses as of the Spin-off Date and related to the sale of the Non-core Businesses; third party failures to achieve timely, effective Year 2000 remediation; and the potential inability to identify qualified franchisees to purchase Company restaurants at prices we consider appropriate under our strategy to reduce the percentage of system units we operate.

Industry risks and uncertainties include, but are not limited to, global and local business and economic and political conditions; legislation and governmental regulation; competition; success of operating initiatives and advertising and promotional efforts; volatility of commodity costs and increases in minimum wage and other operating costs; availability and cost of land and construction; adoption of new or changes in accounting policies and practices; consumer preferences, spending patterns and demographic trends; political or economic instability in local markets; and currency exchange rates.

Consolidated Statement of Operations
(in millions)
TRICON Global Restaurants, Inc. and Subsidiaries
Fiscal years ended December 27, 1997, December 28, 1996 and December 30, 1995

	1997	1996	1995
Revenues			
Company sales	**$9,112**	$ 9,738	$ 9,813
Franchise and license fees	**569**	494	437
	9,681	10,232	10,250
Costs and Expenses, net			
Company restaurants			
Food and paper	**2,949**	3,215	3,242
Payroll and employee benefits	**2,614**	2,793	2,784
Occupancy and other operating expenses	**2,494**	2,711	2,713
	8,057	8,719	8,739
General, administrative and other expenses	**962**	932	857
Facility actions net loss (gain)	**247**	(37)	402
Unusual charges	**174**	246	
Total costs and expenses, net	**9,440**	9,860	9,998
Operating Profit	**241**	372	252
Interest expense, net	**276**	300	355
(Loss) Income Before Income Taxes	**(35)**	72	(103)
Income Tax Provision	**76**	125	29
Net Loss	**$ (111)**	$ (53)	$ (132)

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows

(in millions)

TRICON Global Restaurants, Inc. and Subsidiaries

Fiscal years ended December 27, 1997, December 28, 1996 and December 30, 1995

	1997	1996	1995
Cash Flows – Operating Activities			
Net loss	**$ (111)**	$ (53)	$(132)
Adjustments to reconcile net loss to net cash provided by operating activities			
Depreciation and amortization	**536**	621	671
Facility actions net loss (gain)	**247**	(37)	402
Unusual charges	**174**	246	
Deferred income taxes	**(138)**	(150)	(233)
Other non-cash charges and credits, net	**65**	73	68
Changes in operating working capital, excluding effects of acquisitions and dispositions			
Accounts and notes receivable	**(22)**	(16)	(12)
Inventories	**3**	27	(22)
Prepaid expenses, deferred income taxes and other current assets		(2)	10
Accounts payable and other current liabilities	**13**	85	25
Income taxes payable	**43**	(81)	36
Net change in operating working capital	**37**	13	37
Net Cash Provided by Operating Activities	**810**	713	813
Cash Flows – Investing Activities			
Capital spending	**(541)**	(620)	(701)
Refranchising of restaurants	**770**	355	165
Sales of non-core businesses	**186**		
Sales of property, plant and equipment	**40**	45	43
Other, net	**11**	(29)	(104)
Net Cash Provided by (Used for) Investing Activities	**466**	(249)	(597)
Cash Flows – Financing Activities			
Proceeds from Term Loan Facility	**2,000**		
Proceeds from Revolving Credit Facility	**2,550**		
Payments on Revolving Credit Facility	**(115)**		
Payments of long-term debt	**(65)**	(57)	(17)
Short-term borrowings–three months or less, net	**83**	(80)	25
Decrease in investments by and advances from PepsiCo	**(3,281)**	(285)	(226)
Dividend to PepsiCo	**(2,369)**		
Other, net	**59**		
Net Cash Used for Financing Activities	**(1,138)**	(422)	(218)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	**(7)**	1	(2)
Net Increase (Decrease) in Cash and Cash Equivalents	**131**	43	(4)
Cash and Cash Equivalents – Beginning of Year	**137**	94	98
Cash and Cash Equivalents – End of Year	**$ 268**	$ 137	$ 94
Supplemental Cash Flow Information			
Interest paid	**$ 64**	$ 34	$ 48
Income taxes paid	**210**	325	253

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheet
(in millions)
TRICON Global Restaurants, Inc. and Subsidiaries
December 27, 1997 and December 28, 1996

	1997	1996
Assets		
Current Assets		
Cash and cash equivalents	$ 268	$ 137
Short-term investments, at cost	33	50
Accounts and notes receivable, less allowance: $20 in 1997 and $9 in 1996	149	125
Inventories	73	88
Prepaid expenses, deferred income taxes and other current assets	160	229
Non-core assets held for disposal		333
Total Current Assets	683	962
Property, Plant and Equipment, net	3,261	4,050
Intangible Assets, net	812	1,100
Investments in Unconsolidated Affiliates	143	228
Other Assets	199	180
Total Assets	$ 5,098	$6,520
Liabilities and Shareholders' (Deficit) Equity		
Current Liabilities		
Accounts payable and other current liabilities	$ 1,260	$1,200
Income taxes payable	195	157
Short-term borrowings	124	59
Total Current Liabilities	1,579	1,416
Long-term Debt	4,551	231
Other Liabilities and Deferred Credits	555	434
Deferred Income Taxes	33	200
Total Liabilities	6,718	2,281
Shareholders' (Deficit) Equity		
Preferred stock, no par value, 250 shares authorized; no shares issued		
Common stock, no par value, 750 shares authorized; 152 shares issued and outstanding in 1997	1,271	
Investments by and advances from PepsiCo		4,266
Accumulated deficit	(2,763)	
Currency translation adjustment	(128)	(27)
Total Shareholders' (Deficit) Equity	(1,620)	4,239
Total Liabilities and Shareholders' (Deficit) Equity	$ 5,098	$6,520

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Shareholders' (Deficit) Equity

(in millions)

TRICON Global Restaurants, Inc. and Subsidiaries

Fiscal years ended December 27, 1997, December 28, 1996 and December 30, 1995

	Issued Common Stock		Accumulated Deficit	Investments by and Advances from PepsiCo	Currency Translation Adjustment	Total
	Shares	Amount				
Balance at December 31, 1994	-	$ -	$ -	$4,962	$ 40	$ 5,002
Net investments by and advances from PepsiCo				(226)		(226)
Currency translation adjustment					(69)	(69)
Net loss				(132)		(132)
Balance at December 30, 1995				4,604	(29)	4,575
Net investments by and advances from PepsiCo				(285)		(285)
Currency translation adjustment					2	2
Net loss				(53)		(53)
Balance at December 28, 1996				4,266	(27)	4,239
Net investments by and advances from PepsiCo				(1,150)		(1,150)
Net income prior to Spin-off				283		283
Spin-off dividend and partial repayment of advances			(2,369)	(2,131)		(4,500)
Issuance of shares of common stock, no par value, in connection with the Spin-off	152					-
Contribution to capital of remaining unpaid advances		1,268		(1,268)		-
Stock option exercises		3				3
Currency translation adjustment					(101)	(101)
Net loss after Spin-off			(394)			(394)
Balance at December 27, 1997	152	$1,271	$(2,763)	$ -	$ (128)	$(1,620)

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(tabular amounts in millions, except share data)

Note 1 – Description of Business

TRICON Global Restaurants, Inc. and Subsidiaries (collectively referred to as "TRICON" or the "Company") is the world's largest quick service restaurant company based on the number of system units, with more than 29,000 restaurants in 103 countries and territories. References to TRICON throughout these Consolidated Financial Statements are made using the first person notations of "we" or "our." The worldwide business of our core concepts, KFC, Pizza Hut and Taco Bell, include the operations, development, franchising, and licensing of a system of both traditional and non-traditional quick service restaurant units featuring dine-in, carryout, and in some instances drive-thru or delivery service. Each concept has proprietary menu items and emphasizes the preparation of food with high quality ingredients as well as unique recipes and special seasonings to provide appealing, tasty, and attractive food at competitive prices. We also previously operated other non-core concepts disposed of in 1997, which included California Pizza Kitchen ("CPK"), Chevys Mexican Restaurant ("Chevys"), D'Angelo Sandwich Shop ("D'Angelo"), East Side Mario's ("ESM") and Hot 'n Now ("HNN") (collectively, the "Non-core Businesses"). As of year-end 1997, 38% of total worldwide units were operated by us or international joint ventures in which we participate and 62% by our franchisees and licensees. Approximately 31% of our system units are located outside the United States. Three years ago, we determined that the system should be rebalanced toward franchising and that underperforming units should be closed and, to that end, over 2,300 units have been refranchised and 1,300 units have been closed through December 27, 1997. We expect to continue to develop new Company and franchised units both domestically and internationally and to continue to refranchise existing Company restaurants.

On October 6, 1997 (the "Spin-off Date"), we became a publicly owned company via a tax-free distribution of our Common Stock (the "Distribution" or "Spin-off") to the shareholders of our former parent, PepsiCo, Inc. ("PepsiCo"). A description of the Spin-off and certain transactions with PepsiCo is included in Note 3.

Note 2 - Summary of Significant Accounting Policies

Preparation of the accompanying Consolidated Financial Statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from our estimates.

Principles of Consolidation and Basis of Preparation. The accompanying Consolidated Financial Statements present our financial position, results of operations and cash flows as if we had been an independent, publicly owned company for all periods presented. Certain allocations of previously unallocated PepsiCo interest and general and administrative expenses, as well as computations of separate tax provisions, have been made to facilitate such presentation. See Note 3. The Consolidated Financial Statements prior to October 6, 1997 represent the former combined worldwide operations of KFC, Pizza Hut and Taco Bell and the Non-core Businesses disposed of in 1997. Intercompany accounts and transactions have been eliminated. Investments in unconsolidated affiliates in which we exercise significant influence but do not control are accounted for by the equity method, and our share of the net income or loss of our unconsolidated affiliates and foreign exchange losses is included in general, administrative and other expenses.

Fiscal Year. Our fiscal year ends on the last Saturday in December and, as a result, a fifty-third week is added every five or six years. Fiscal years 1997, 1996 and 1995 comprise 52 weeks. The first, second and third quarters of each year include 12 weeks each, while the fourth quarter includes 16 weeks.

Direct Marketing Costs. Direct marketing costs are reported in occupancy and other operating expenses in the Consolidated Statement of Operations and include costs of advertising and other marketing activities. Direct marketing costs are charged to expense ratably in relation to revenues over the year in which incurred. Advertising expenses were $544 million, $571 million and $570 million in 1997, 1996 and 1995, respectively.

Research and Development Expenses. Research and development expenses, which are expensed as incurred, were $21 million, $20 million and $17 million in 1997, 1996 and 1995, respectively.

Stock-Based Employee Compensation. As permitted by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), we measure stock-based employee compensation cost for financial statement purposes in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and its related interpretations ("APB Opinion No. 25") and include pro forma information in Note 13. Accordingly, compensation cost for the stock option grants to our employees is measured as the

excess of the quoted market price of our common stock at the grant date over the amount the employee must pay for the stock. Our policy is to generally grant stock options at the fair market value of the underlying common stock at the date of the grant.

Loss per Common Share. Historical loss per share has been omitted since we were not an independent, publicly owned company with a capital structure of our own for any of the fiscal years presented in the accompanying Consolidated Statement of Operations.

Net loss per share for the fourth quarter of 1997, included in Note 18, is computed by dividing the net loss by the weighted average number of shares outstanding. In 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128"). SFAS 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options. Additionally, the dilutive effects of options are not included when losses from continuing operations exist.

Derivative Instruments. From time to time, we utilize interest rate swaps to hedge our exposure to fluctuations in variable interest rates. The interest differential to be paid or received on an interest rate swap is recognized as an adjustment to interest expense as the differential occurs. The interest differential not yet settled in cash is reflected in the accompanying Consolidated Balance Sheet as a receivable or payable under the appropriate current asset or liability caption. If an interest rate swap position was to be terminated, the gain or loss realized upon termination would be deferred and amortized to interest expense over the remaining term of the underlying debt instrument it was intended to modify or would be recognized immediately if the underlying debt instrument was settled prior to maturity.

Gains and losses on futures contracts that are designated and effective as hedges of future commodity purchases are deferred and included in the cost of the related raw materials when purchased. Changes in the value of futures contracts that we use to hedge commodity purchases are highly correlated to the changes in the value of the purchased commodity. If the degree of correlation between the futures contracts and the purchase contracts were to diminish such that the two were no longer considered highly correlated, subsequent changes in the value of the futures contracts would be recognized in income.

Cash and Cash Equivalents. Cash equivalents represent funds temporarily invested (with original maturities not exceeding three months) as part of managing day-to-day operating cash receipts and disbursements.

Inventories. Inventories are valued at the lower of cost (computed on the first-in, first-out method) or net realizable value.

Property, Plant and Equipment. Property, plant and equipment ("PP&E") are stated at cost less accumulated depreciation and amortization, except for PP&E that have been impaired, for which the carrying amount is reduced to estimated fair market value which becomes the new cost basis. Depreciation and amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows: 5 to 25 years for buildings and improvements and 3 to 20 years for machinery and equipment. Depreciation and amortization expense was $460 million, $521 million and $555 million in 1997, 1996 and 1995, respectively.

Intangible Assets. Intangible assets include both identifiable intangibles and goodwill arising from the allocation of purchase prices of businesses acquired. Amounts assigned to identifiable intangibles are based on independent appraisals or internal estimates. Goodwill represents the residual purchase price after allocation to all identifiable net assets. Intangible assets are stated at historical allocated cost less accumulated amortization, except for intangibles that have been impaired, for which the carrying amount is reduced to estimated fair market value which becomes the new cost basis. Intangible assets are amortized on a straight-line basis as follows: 20 years for reacquired franchise rights, 3 to 34 years for trademarks and other identifiable intangibles and 20 years for goodwill. Amortization expense was $70 million, $95 million and $109 million in 1997, 1996 and 1995, respectively.

Impairment of Long-Lived Assets to be Held and Used in the Business. We review our long-lived assets related to each restaurant to be held and used in the business semi-annually for impairment, or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. We evaluate restaurants using a "two-year history of operating losses" as our primary indicator of potential impairment. An impaired restaurant is written down to its estimated fair market value based on the best information available. We generally measure estimated fair market value by discounting estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows. Accordingly, actual results could vary significantly from such estimates.

Impairment of Investments in Unconsolidated Affiliates and Enterprise–Level Goodwill. Our methodology for determining and measuring impairment of our investments in unconsolidated affiliates and enterprise-level goodwill was changed in 1996 to conform with the methodology we use for our restaurants

except (a) the recognition test for an investment in an unconsolidated affiliate compares the carrying amount of the investment to a forecast of our share of the unconsolidated affiliate's undiscounted cash flows including interest and taxes, compared to undiscounted cash flows before interest and taxes used for restaurants and (b) enterprise-level goodwill is evaluated at a country level instead of by individual restaurant. The change in methodology had no impact in 1996. Also, impairment charges related to investments in unconsolidated affiliates are recorded when other circumstances indicate that a decrease in value of the investment has occurred which is other than temporary.

Pre-opening Costs. Costs associated with opening a new restaurant are expensed as incurred.

Refranchising Gains (Losses). Refranchising gains (losses) include gains or losses on sales of Company restaurants to new and existing franchisees and the related initial franchise fees. Direct administrative costs of refranchising are included in the gain or loss calculation. Gains on restaurant refranchisings are recognized when the sale transaction closes, the franchisee has a minimum amount of the purchase price in at-risk equity and we are satisfied that the franchisee can meet its financial obligations. Otherwise, refranchising gains are deferred until those criteria have been met. Losses on restaurant refranchisings are recognized when a decision is made to refranchise a store within the next twelve months and the estimated fair value less costs to sell is less than the carrying amount of the store.

Store Closure Costs. Store closure costs are recognized when a decision is made to close a restaurant within the next twelve months. Store closure costs include the cost of writing-down (impairing) the carrying amount of a restaurant's assets to estimated fair market value less costs of disposal and the net present value of any remaining operating lease payments after the expected closure date, net of estimated sub-lease income.

Franchise and License Fees. Franchise or license agreements are executed for each point of distribution and provide the terms of the arrangement with the franchisee/licensee. The franchise and certain license agreements require the franchisee/licensee to pay an initial, non-refundable fee. The agreements also require continuing fees based upon a percentage of sales. Subject to franchisor approval and payment of a renewal fee, a franchise agreement may generally be renewed upon expiration.

Initial fees are recognized as revenue when we have substantially performed all initial services required by the franchising/licensing agreement, which is generally upon the opening of a store. Continuing fees are recognized as earned with an appropriate provision for estimated uncollectible amounts. Renewal fees are recognized in earnings when a renewal agreement becomes effective.

Direct costs incurred to secure and perform the required services under the franchise and license agreements, which are not material, are charged to expense as incurred.

Reclassifications. Certain items have been reclassified in the accompanying Consolidated Financial Statements for prior periods in order to be comparable with the classification adopted for the fiscal year ended December 27, 1997. Such reclassifications had no effect on previously reported net income.

Note 3 – Spin-off from and Transactions with Former Affiliates

On the Spin-off Date, we became an independent, publicly owned restaurant company encompassing the combined worldwide operations of KFC, Pizza Hut and Taco Bell (the "Core Business(es)") as well as the Non-core Businesses which were disposed of prior to the Spin-off.

Spin-off and relationship after the Spin-off. At the Spin-off Date, our common shares were distributed to the record date holders of PepsiCo common shares at a ratio of one share for each ten outstanding PepsiCo shares. After the Spin-off, PepsiCo had no ownership in us. Immediately after the Spin-off, however, certain of our shares were held by the PepsiCo pension trust on behalf of PepsiCo employees. We have entered into separation and other related agreements, (the "Separation Agreement") outlined below, governing the Spin-off transaction and our subsequent relationship with PepsiCo. Such agreements provide certain indemnities to the parties, and provide for the allocation of tax and other assets, liabilities and obligations arising from periods prior to the Spin-off. In addition, KFC, Pizza Hut and Taco Bell have each entered into a multi-year agreement with Pepsi-Cola Company, a wholly owned subsidiary of PepsiCo, regarding the purchase of beverage products. We have also signed a multi-year agreement with PFS, a former distribution affiliate, for the distribution of certain products and supplies to U.S. Company units. Neither contract is for quantities expected to exceed normal usage.

The Separation Agreement provided for, among other things, our assumption of all liabilities relating to the restaurant businesses, inclusive of the Non-core Businesses, and the indemnification of PepsiCo with respect to such liabilities. The Separation Agreement provided that we pay, prior to the Spin-off, $4.5 billion to PepsiCo as repayment of certain amounts due to PepsiCo and as a dividend. The net investment by and advances from PepsiCo were preliminarily determined

to be approximately $3.4 billion at the Spin-off Date. The amount we repaid to PepsiCo in connection with the Spin-off was approximately $2.1 billion and the dividend we paid was approximately $2.4 billion. PepsiCo contributed to our capital its remaining unpaid advances of approximately $1.3 billion, as provided by the Separation Agreement. The Agreement also specifies that PepsiCo shall make a final determination regarding the net assets of the restaurant businesses transferred to us at the Spin-off Date. This determination has been preliminarily completed, but is subject to our agreement. The accompanying Consolidated Financial Statements reflect our estimates, based on available information, of the net assets that should be transferred. The final approved determination could vary from these estimates. Any changes are not expected to materially affect future net income.

In addition, a fee will be paid to PepsiCo for all letters of credit, guarantees and contingent liabilities relating to our businesses under which PepsiCo remains liable until such time as they are released, terminated or replaced by a qualified letter of credit covering the full amount of such contingencies under such letters of credit, guarantees and contingent liabilities. Payments for such fees to PepsiCo during 1997 totaled less than $1 million. We have indemnified PepsiCo for any costs or losses incurred with respect to such letters of credit, guarantees and contingent liabilities.

In connection with the Spin-off, PepsiCo received a ruling from the Internal Revenue Service (the "IRS") to the effect, among other things, that the Spin-off would qualify as a tax-free reorganization under Sections 355 and 368 of the Internal Revenue Code of 1986, as amended. Such a ruling, while generally binding upon the IRS, is subject to certain factual representations and assumptions provided by PepsiCo. The Company has agreed to certain restrictions on its future actions to provide further assurances that the Spin-off will qualify as tax-free. Restrictions include, among other things, limitations on the liquidation, merger or consolidation with another company, certain issuances and redemptions of our Common Stock, the granting of stock options and the sale, refranchising, distribution or other disposition of assets. If we fail to abide by such restrictions or obtain waivers from PepsiCo and, as a result, the Spin-off fails to qualify as a tax-free reorganization, we will be obligated to indemnify PepsiCo for any resulting tax liability, which could be substantial.

Under the separation agreements, PepsiCo maintains full control and absolute discretion with regard to any combined or consolidated tax filings for periods through the Spin-off Date. PepsiCo also maintains full control and absolute discretion regarding common tax audit issues of such entities. Although PepsiCo has contractually agreed to, in good faith, use its best efforts to settle all joint interests in any common audit issue on a consistent basis with prior practice, there can be no assurance that determinations so made by PepsiCo would be the same as we would reach, acting on our own behalf.

The separation agreements specify methods for allocation of assets, liabilities and responsibilities with respect to certain existing employee compensation and benefit plans and programs. Such allocations have been preliminarily completed for current and retired employees of the restaurant businesses. In addition, all vested PepsiCo options held by our employees were not converted to TRICON options. We have agreed to indemnify PepsiCo as to any employer payroll tax it incurs related to the exercise of such options after the Spin-off. Certain provisions of the agreements also govern the transfer of employees between the parties during the transition period ending in 1998. We have also agreed on arrangements between the parties with respect to certain internal software, third-party agreements, telecommunications services and computing services.

Allocations and Determination of Common Costs in Historical Financial Statements. Prior to the Spin-off, our operations were financed through our operating cash flows, refranchising proceeds and investments by and advances from PepsiCo. For this reason, our historical financial statements include interest expense on our external debt plus an allocation of interest expense which had not previously been separately allocated by PepsiCo. These interest allocations were based on PepsiCo's weighted average interest rate applied to the average annual balance of investments by and advances from PepsiCo.

Additionally, our historical financial statements include an allocation of PepsiCo's previously unallocated general and administrative expenses. These allocations were based on our revenue as a percentage of PepsiCo's total revenue.

The amounts, by year, of the historical allocations described above are as follows:

	1997 through Spin-off Date	1996	1995
Interest allocated	**$188**	$275	$316
PepsiCo weighted-average interest rate	**6.1%**	6.2%	6.6%
General and administrative expense allocated	**$ 37**	$ 53	$ 52

We believe that the bases of allocation of interest and general and administrative expenses were reasonable based on the facts available at the date of their allocation. However, based on current information, such amounts are not indicative of amounts which we would have incurred if we had been an independent, publicly owned entity for all periods presented. As noted in the accompanying Consolidated Balance Sheet, our capital structure changed as a result of the Distribution to PepsiCo and bears little relationship to the average net outstanding investments by and advances from PepsiCo as the $4.5 billion in borrowings to fund the dividend and repayments exceed the net aggregate balance owed to PepsiCo at the Spin-off Date. We will be required to add personnel and incur other costs to perform services previously provided by PepsiCo. The full cost reflective of our capital structure and our personnel complement will be included in our Consolidated Statement of Operations as incurred. See Note 16.

For periods prior to the Spin-off, income tax expense was calculated, to the extent possible, as if we had filed separate income tax returns. As PepsiCo managed its tax position on a consolidated basis, which takes into account the results of all of its businesses, our effective tax rate in the future could vary significantly from our historical effective tax rates. Our future effective tax rate will be largely dependent on our structure and tax strategies as a separate entity.

Note 4 – Items Affecting Comparability of Net Loss

Certain large charges (credits) are identified below due to either their inherent variability or unusual nature to enhance comparability of periods presented. Facility actions net loss (gain) reflects both our initiative to reduce our percentage ownership of total system units by selling Company restaurants to new and existing franchisees and our committing to close underperforming stores. Impairment charges for restaurants we intend to continue to use in the business are also included in facility actions net loss (gain). Unusual charges are primarily related to the 1997 fourth quarter charge and the 1996 decision to dispose of our Non-core Businesses.

	1997		1996		1995	
	Pre-Tax	**After-Tax**	Pre-Tax	After-Tax	Pre-Tax	After-Tax
Facility actions net loss (gain)[a]	**$247**	**$163**	$(37)	$(21)	$402	$295
Unusual charges[b]	**174**	**159**	246	189	-	-

(a) Includes $410 million ($300 million after-tax) related to 1997 fourth quarter charges.

(b) Includes $120 million ($125 million after-tax) related to 1997 fourth quarter charges and an additional $54 million ($34 million after-tax) related to the 1997 disposal of the Non-core Businesses.

1997 Fourth Quarter Charges

	U.S.	International	Worldwide
Store closure costs	$141	$ 72	$213
Refranchising losses	77	59	136
Impairment charges for stores to be used in the business	12	49	61
Total facility actions net loss	230	180	410
Impairment of investments in unconsolidated affiliates		79	79
Severance and other	18	23	41
Total unusual charges	18	102	120
Total fourth quarter charges	$248	$282	$530

The fourth quarter charge of $530 million ($425 million after-tax) represents actions taken to refocus our business. The charge included (1) underperforming store closures, primarily at Pizza Hut and internationally; (2) restaurants we intend to refranchise whose carrying amounts were reduced to fair market value, less costs to sell; (3) impairment of certain restaurants intended to be used in the business; (4) impairment of certain joint ventures; and (5) related personnel reductions.

Facility Actions Net Loss (Gain)

	1997	1997 (Excluding 4th Qtr. Action)	1996	1995
U.S.				
Refranchising gains[a]	$ (67)	$(144)	$(134)	$(89)
Store closure costs	154	13	45	26
Impairment charges for stores to be used in the business	59	47	54	320
Facility actions net loss (gain)	146	(84)	(35)	257
International				
Refranchising gains[a] [b]	(45)	(104)	(5)	(4)
Store closure costs, net	94	22	(5)	12
Impairment charges for stores to be used in the business	52	3	8	137
Facility actions net loss (gain)	101	(79)	(2)	145
Worldwide				
Refranchising gains[a][b]	(112)	(248)	(139)	(93)
Store closure costs	248	35	40	38
Impairment charges for stores to be used in the business	111	50	62	457
Facility actions net loss (gain)	$ 247	$(163)	$ (37)	$402

(a) Includes initial franchise fees in the U.S. of $39 million, $22 million and $8 million in 1997, 1996 and 1995, respectively, and in International of $2 million in 1997. See Note 5.
(b) Includes a tax-free gain of $100 million in 1997 from refranchising our restaurants in New Zealand through an initial public offering.

The impairment charges in 1997 and 1996 resulted from our semi-annual impairment evaluations of each restaurant to be used in the business. We early adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS 121"), as of the beginning of the fourth quarter of 1995. The initial, non-cash charge of $457 million ($324 million after-tax), $120 million of which related to our Non-core Businesses, resulted from our evaluating and measuring impairment of restaurants to be used in the business at the individual restaurant level. Previously, we evaluated and measured impairment if a restaurant concept was incurring operating losses and was expected to incur operating losses in the future.

Unusual Charges

Exclusive of the fourth quarter charge, unusual charges include $54 million in 1997 and $246 million in 1996 resulting from our 1996 decision to dispose of our remaining Non-core Businesses. The 1996 charge represented the reduction of the carrying amounts of the Non-core Businesses to estimated fair market value, less costs to sell. The estimated fair market value was initially determined by using estimated selling prices based upon the opinion of an investment banking firm retained to assist in the selling activity. The 1997 charge adjusted the carrying amount of the Non-core Businesses to their actual selling prices less costs to sell. In accordance with the terms of certain of these transactions and the PepsiCo Separation Agreement, we retained and are holding for disposal certain properties and operating lease liabilities. No value has been assigned to these properties and all the lease liabilities, net of the expected sublease recoveries, have been fully accrued. The Non-core Businesses contributed $268 million, $394 million and $297 million to revenues in 1997, 1996 and 1995, respectively. Excluding the unusual disposal charges in 1997 and 1996 and the $120 million initial impact of adopting SFAS 121 in 1995, the Non-core Businesses realized income of $10 million ($8 million after-tax) in 1997, and incurred losses of $15 million ($12 million after-tax) and $45 million ($37 million after-tax) in 1996 and 1995, respectively.

Note 5 – Franchise and License Fees

Franchise and certain license arrangements for our traditional and non-traditional points of distribution, respectively, provide for initial fees. The agreements also require continuing fees based upon a percentage of sales. Initial franchise fees from refranchising activities arise from an initiative we adopted in late 1994 to reduce our percentage ownership of total system units by selling Company units to new and existing franchisees. As disclosed in Note 2, initial franchise fees from the refranchising activities are included as part of refranchising gains.

	1997	1996	1995
Initial fees, including renewal fees	$ 86	$ 43	$ 28
Initial franchise fees from refranchising activities	(41)	(22)	(8)
	45	21	20
Continuing fees	524	473	417
	$569	$494	$437

Note 6 – Property, Plant and Equipment, net

	1997	1996
Land	$ 834	$ 933
Buildings and improvements	3,163	3,394
Capital leases, primarily buildings	152	206
Machinery and equipment	2,040	2,319
	6,189	6,852
Accumulated depreciation and amortization	(2,928)	(2,802)
	$3,261	$4,050

Note 7 – Intangible Assets, net

	1997	1996
Reacquired franchise rights	$544	$ 764
Trademarks and other identifiable intangibles	132	165
Goodwill	136	171
	$812	$1,100

Accumulated amortization, included in the amounts above, was $508 million and $550 million at year-end 1997 and 1996, respectively.

Note 8 – Accounts Payable and Other Current Liabilities

	1997	1996
Accounts payable	$ 453	$ 526
Accrued compensation and benefits	294	261
Other accrued taxes	103	121
Other current liabilities	410	292
	$1,260	$1,200

Note 9 – Short-term Borrowings and Long-term Debt

	1997	1996
Short-term Borrowings		
Current maturities of long-term debt	$ 19	$ 26
Other	105	33
	$ 124	$ 59
Long-term Debt		
Senior, unsecured Term Loan Facility, due October 2002	$1,968	$ -
Senior, unsecured Revolving Credit Facility, expires October 2002	2,435	-
Capital lease obligations (See Note 10)	140	222
Other, due through 2010 (7.8% and 8.2%)	27	35
	4,570	257
Less current maturities of long-term debt	(19)	(26)
	$4,551	$231

On October 2, 1997, we entered into a $5.25 billion bank credit agreement comprised of a $2 billion senior, unsecured Term Loan Facility and a $3.25 billion senior, unsecured Revolving Credit Facility which mature on October 2, 2002.

The facilities are guaranteed by our principal U.S. subsidiaries. Proceeds of $4.5 billion of the initial $4.55 billion borrowed under the facilities were used to make the Distribution to PepsiCo. The $50 million of additional proceeds has been used to provide cash collateral securing certain obligations previously secured by PepsiCo, to pay fees and expenses related to the Distribution and the bank credit facilities, and for general corporate purposes. Interest on amounts borrowed is payable at least quarterly at rates which are variable, based principally on the London Interbank

Offered Rate ("LIBOR") plus a variable margin factor as defined in the credit agreement. At December 27, 1997, the weighted average interest rate was 6.6% which includes the effects of associated interest rate swaps. See Note 11 for a discussion of our use of interest rate swaps, our management of inherent credit risk and fair value information related to debt and interest rate swaps.

At year-end 1997, we had unused revolving credit agreement borrowings available aggregating $692 million. We pay a facility fee on the revolving credit facility. The margin factor and facility fee rate is determined based on our leverage ratio or third-party senior debt ratings as defined in the agreement. Facility fees accrued at December 27, 1997 were $1.3 million.

The credit facilities are subject to various covenants including financial covenants relating to maintenance of specific leverage and fixed charge coverage ratios. In addition, the facilities contain affirmative and negative covenants including, among other things, limitations on certain additional indebtedness including guarantees of indebtedness, cash dividends, aggregate non-U.S. investment and certain other transactions, as defined in the agreement. At December 27, 1997, we are in compliance with all covenants governing our credit facilities. The credit facilities contain mandatory prepayment terms for certain capital market transactions and sales of restaurants as defined in the agreement. Once the Term Loan has been repaid in full, mandatory prepayments may be required of the revolving credit agreement which would reduce the facility availability. Absent this circumstance, under the terms of the Revolving Credit Facility, we may borrow up to $3.25 billion until maturity. The Revolving Credit Facility is also reduced for letters of credit. Amounts borrowed under the Term Loan Facility that are prepaid may not be reborrowed.

The annual maturities of long-term debt through 2002, excluding capital lease obligations, are 1998 – $5 million; 1999 - $12 million; 2000 - $4 million; 2001 - $3 million and 2002 - $4.4 billion.

Note 10 – Leases

We have non-cancelable commitments under both capital and long-term operating leases, primarily for Company restaurants. Capital and operating lease commitments expire at various dates through 2067 and, in many cases, provide for rent escalations and renewal options. Most leases require payment of related executory costs, which include property taxes, maintenance and insurance.

Future minimum commitments and sublease receivables under non-cancelable leases are set forth below:

	Commitments		Sublease Receivables	
			Direct	
	Capital	Operating	Financing	Operating
1998	$ 26	$ 253	$ 3	$12
1999	24	219	2	11
2000	23	190	2	9
2001	21	170	2	8
2002	20	152	2	7
Later Years	153	801	15	38
	$267	$1,785	$26	$85

At year-end 1997, the present value of minimum payments under capital leases was $140 million, after deducting $127 million representing imputed interest.

The details of rental expense and income are set forth below:

	1997	1996	1995
Rental expense			
Minimum	**$317**	$312	$309
Contingent	**30**	32	27
	$347	$344	$336
Minimum rental income	**$ 19**	$ 16	$ 8

Contingent rentals are based on sales in excess of levels stipulated in the lease agreements.

Note 11 - Financial Instruments

Derivative Instruments

Our policy prohibits the use of derivative instruments for trading purposes, and we have procedures in place to monitor and control their use. As of December 27, 1997, our use of derivative instruments was limited to interest rate swaps entered into with financial institutions and commodity futures contracts traded on national exchanges.

Interest rate swaps are entered into with the objective of reducing our exposure to interest rate risk. During 1997, we entered into interest rate swaps to effectively convert a portion of our variable rate bank debt to fixed rate. Reset dates and the floating rate index on the swaps match those of the underlying bank debt. Accordingly, any market risk or opportunity associated with swaps is offset by the opposite market impact on the related debt. Credit risk from the swap agreements is dependent both on the movement in interest rates and the possibility of non-payment by swap counterparties. We mitigate credit risk by only entering into swap agreements with high credit-quality counterparties and by netting swap payments within each contract. At December 27, 1997, we had entered into interest rate swaps with notional amounts of $1 billion. Under the contracts, we agree with other parties to exchange, at specified intervals, the difference between variable-rate and fixed-rate amounts calculated on a notional principal amount. At December 27, 1997, the average pay rate was 5.97%. The payables under the related swaps aggregated $.2 million at December 27, 1997. The swaps mature at various dates through 2001.

Open commodity future contracts and deferred gains and losses at year-end 1997 and 1996, as well as gains and losses recognized as part of cost of sales in 1997, 1996 and 1995 were not significant.

Fair Value

Except for guarantees issued by us and interest rate swaps outstanding, the carrying amounts of our financial instruments approximate fair value. The fair value of our guarantees issued was $18 million in 1997 and $13 million in 1996 compared to carrying amounts of $0. The fair value of our interest rate swaps was $1.5 million compared to a carrying amount of $.2 million.

Note 12 - Pension Plans and Other Benefit Programs

We sponsor noncontributory defined benefit pension plans covering substantially all full-time U.S. salaried employees and certain hourly employees and noncontributory defined benefit pension plans covering certain international employees. Prior to the Spin-off, the participants in the plans were covered by plans with similar benefits, sponsored by PepsiCo. Under an agreement with PepsiCo, we have assumed or retained pension liabilities related to substantially all of our participants. Assets of the PepsiCo plans have been allocated in accordance with regulatory rules between the PepsiCo plans and our plans. Benefits generally are based on years of service and compensation or stated amounts for each year of service. All plans but one are funded and contributions to U.S. plans are made in amounts not less than minimum statutory funding requirements nor more than the maximum amount that can be deducted for U.S. income tax purposes. The U.S. plans' assets consist principally of equity securities, government and corporate debt securities and other fixed-income obligations.

The components of net pension expense for U.S. plans are set forth below. Net periodic pension expense for international plans was immaterial.

	1997	1996	1995
Service cost of benefits earned	**$18**	$15	$12
Interest cost on projected benefit obligation	**17**	15	12
Return on plan assets:			
Actual gain	**(60)**	(26)	(44)
Deferred gain	**41**	9	29
Amortization of net transition gain	**(4)**	(4)	(4)
Net other amortization	**1**	1	
Net pension expense	**$13**	$10	$ 5

Reconciliations of the funded status of the U.S. plans to the pension liability recognized in the Consolidated Balance Sheet are set forth below. Amounts related to international plans were immaterial.

	Assets Exceed Accumulated Benefits		Accumulated Benefits Exceed Assets	
	1997	1996	**1997**	1996
Actuarial present value of benefit obligation				
Vested benefits	**$(194)**	$(121)	**$ (6)**	$(17)
Non-vested benefits	**(26)**	(23)	**(1)**	(5)
Accumulated benefit obligation	**(220)**	(144)	**(7)**	(22)
Effect of projected compensation increases	**(40)**	(31)	**(19)**	(13)
Projected benefit obligation	**(260)**	(175)	**(26)**	(35)
Plan assets at fair value	**270**	209		14
Plan assets in excess of (less than) projected benefit obligation	**10**	34	**(26)**	(21)
Unrecognized prior service cost (benefit)	**(1)**		**4**	3
Unrecognized net (gain) loss	**(14)**	(28)	**8**	11
Unrecognized net transition (gain) loss	**(2)**	(6)		
Adjustment required to recognize minimum liability				(4)
Accrued pension liability	**$ (7)**	$ -	**$(14)**	$(11)

The assumptions used to compute the information above are set forth below:

	1997	1996	1995
Expected long-term rate of return on plan assets	**10.0%**	10.0%	10.0%
Discount rate – projected benefit obligation	**7.1%**	7.7%	7.7%
Future compensation growth rate	**5.2-6.6%**	5.2-6.6%	5.2-6.6%

We also sponsor certain deferred compensation benefit programs for eligible employees and non-employee directors that allow participants to defer receipt of portions of their annual salary and incentive compensation. Amounts deferred are credited with earnings based on certain phantom investment options selected by the participants, as defined by the benefit program. These earnings amounts are expensed as incurred. Our obligations under these programs as of year-end 1997 and 1996 were $37 million and $29 million, respectively. In late 1997, a new investment option allowed participants to defer certain incentive compensation earned in 1997 into the purchase of phantom shares of TRICON Common Stock at a 25% discount from fair market value at the date of deferral in 1998. Participants bear the risk of forfeiture if they voluntarily separate from employment during the two year vesting period. The intrinsic value of the discount will be expensed over the vesting period stipulated by the benefit program. Amounts expensed under these programs for all periods presented were not significant.

Note 13 - Employee Stock-Based Compensation

(tabular options in thousands)

At year-end 1997, we had two stock option plans in effect, the 1997 Long-Term Incentive Plan ("LTIP") and the TRICON Global Restaurants, Inc. SharePower Plan ("SharePower"). Options to purchase up to 22.5 million shares of stock may be granted under the LTIP at a price equal to or greater than the market value of the stock on the date of grant. New options granted can have varying vesting provisions and exercise periods. Options granted subsequent to the Spin-off vest in periods ranging from immediate to 2006 and expire ten to fourteen years after grant. Potential awards to employees and non-employee directors under the LTIP include stock options, performance units, incentive stock options, stock appreciation rights and restricted stock. Only LTIP stock options and restricted stock have been issued since the Spin-off. Additionally, it is not anticipated that any further grants will be made pursuant to the SharePower plan although options previously granted could be outstanding through 2006. We account for these plans under APB Opinion No. 25, as permitted by SFAS 123.

At the Spin-off Date, certain of the options to purchase PepsiCo stock that were held by our employees were converted to TRICON stock options under either the LTIP or the SharePower plan. The options were converted at amounts and exercise prices that maintained the amount of unrealized stock appreciation that existed immediately prior to the Spin-off. The vesting dates and exercise periods of the options were not affected by the conversion. Based on their original PepsiCo grant date, TRICON converted options vest in periods ranging from one to ten years and expire ten to fifteen years after grant.

Had compensation cost for all TRICON option grants subsequent to the Spin-off to employees and non-employee directors been determined consistent with SFAS 123, our net loss for 1997 would have increased from $111 million to $112 million. The pro forma net loss may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense over the vesting period, which was only a partial year in 1997, and additional options may be granted in varying quantities in future years. SFAS 123 pro forma loss per share data is not meaningful as we were not an independent, publicly owned company prior to the Spin-off.

The fair value of each option grant made subsequent to the Spin-off was estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in fiscal 1997:

Risk-free interest rate	5.79%
Expected life	6.6 years
Expected volatility	27.5%
Expected dividend yield	0%

A summary of the status of all options granted to employees and non-employee directors at December 27, 1997, and changes during the year then ended is presented in the table below:

	December 27, 1997	
	Options	Wtd. Avg. Ex. Price
Outstanding at beginning of year	-	$ -
Conversion of PepsiCo options	13,951	21.48
Granted at price equal to market	872	32.95
Granted at price greater than market	1,334	31.63
Exercised	(112)	24.80
Forfeited	(800)	20.84
Outstanding at end of year	**15,245**	**$23.03**
Exercisable at end of year	**1,251**	**$23.84**
Weighted average of fair value of options granted	**$13.37**	

The following tables summarize information about all stock options outstanding at December 27, 1997:

	Options Outstanding		
Range of Exercise Prices	Options	Wtd. Avg. Remaining Contractual Life in Years	Wtd. Avg. Ex. Price
$ .01 - 17.80	3,994	6.80	$14.96
22.02 - 29.40	9,044	8.29	24.37
30.41 - 34.47	2,207	10.12	32.15
	15,245		

	Options Exercisable	
Range of Exercise Prices	Options	Wtd. Avg Ex. Price
$ .01 - 17.80	91	$ 9.49
22.02 - 29.40	1,144	24.87
30.41 - 34.47	16	31.63
	1,251	

In November 1997, we granted two awards of restricted performance units of TRICON's Common Stock to our Vice Chairman/President. The awards were made under the LTIP and may be paid in Common Stock of TRICON or cash at the discretion of the Board of Directors. Payment of the awards, totaling $6.3 million, is contingent upon continued employment through January 25, 2001 and 2006, respectively, and the attainment by TRICON of certain pre-established earnings thresholds, as defined. The awards are being expensed over the performance periods stipulated above; the amount included in earnings in 1997 was not significant.

Note 14 - Income Taxes

The details of the income tax provision are set forth below:

	1997	1996	1995
Current:			
Federal	**$ 106**	$ 154	$ 179
Foreign	**77**	93	59
State	**31**	28	24
	214	275	262
Deferred:			
Federal	**(66)**	(127)	(168)
Foreign	**(59)**	(5)	(55)
State	**(13)**	(18)	(10)
	(138)	(150)	(233)
	$ 76	$ 125	$ 29

U.S. and foreign (loss) income before income taxes are set forth below:

	1997	1996	1995
U.S.	**$ 13**	$(21)	$ 72
Foreign	**(48)**	93	(175)
	$(35)	$ 72	$(103)

A reconciliation of income taxes calculated at the U.S. Federal tax statutory rate to our income tax provision is set forth below:

	1997	1996	1995
Income taxes computed at the U.S. Federal statutory rate of 35%	**$(12)**	$ 25	$(36)
State income tax, net of Federal tax benefit	**20**	7	7
Foreign and U.S. tax effects attributable to foreign operations	**24**	49	26
Effect of unusual charges	**79**	28	
Effect of the New Zealand IPO	**(41)**		
Initial impact of adopting SFAS 121			28
Nondeductible amortization of U.S. goodwill	**6**	9	11
Federal tax credits	**(2)**	(2)	(8)
Other, net	**2**	9	1
Income tax provision	**$ 76**	$125	$ 29
Effective income tax rate	**(217.1)%**	173.6%	(28.2)%

The details of the 1997 and 1996 deferred tax liabilities (assets) are set forth below:

	1997	1996
Intangible assets and property, plant and equipment	**$ 253**	$ 250
Other	**5**	15
Gross deferred tax liabilities	**$ 258**	$ 265
Net operating loss and tax credit carryforwards	**$ (89)**	$(117)
Employee benefits	**(48)**	(56)
Casualty claims	**(57)**	(69)
Fourth quarter charge	**(105)**	
Various liabilities and other	**(141)**	(126)
Gross deferred tax assets	**(440)**	(368)
Deferred tax assets valuation allowance	**111**	138
Net deferred tax assets	**(329)**	(230)
Net deferred tax (asset) liability	**$ (71)**	$ 35
Included in:		
Prepaid expenses, deferred income taxes and other current assets	**$ (92)**	$(165)
Other assets	**(12)**	
Deferred income taxes	**33**	200
	$ (71)	$ 35

The valuation allowance related to deferred tax assets decreased by $27 million in 1997 primarily due to the disposal of the Non-core Businesses.

The determination of the unrecognized deferred tax liability for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration is not practicable.

Net operating loss carryforwards totaling $307 million at year-end 1997 are available to reduce future tax of TRICON and certain subsidiaries and are related to a number of foreign and state jurisdictions. Of these carryforwards, $20 million expire in 1998, $221 million expire at various times between 1999 and 2012 and $66 million may be carried forward indefinitely.

Note 15 - Business Segments

We are engaged principally in developing, operating, franchising and licensing the worldwide KFC, Pizza Hut and Taco Bell concepts. We also previously operated other non-core U.S. concepts, including CPK, Chevys, D'Angelo, ESM and HNN, all of which were sold in 1997 prior to the Spin-off. See Note 4.

KFC, Pizza Hut and Taco Bell operate throughout the U.S. and in 78, 87 and 15 countries and territories outside the U.S., respectively. Principal international markets include Australia, Canada, China, Japan, Korea, Mexico, Poland, Puerto Rico, and the U.K. At year-end 1997, we had investments in several unconsolidated affiliates outside the U.S. which operate KFC and Pizza Hut restaurants, the most significant of which are corporate joint ventures located in Japan and the U.K.

Geographic Areas

	Revenues		
	1997	1996	1995
United States	**$7,363**	$ 7,924	$ 8,163
International	**2,318**	2,308	2,087
	$9,681	$10,232	$10,250

	Operating Profit		
	1997[a]	1996[a]	1995[a]
United States	**$ 397**	$ 304	$ 328
International	**(30)**	144	(26)
Foreign exchange	**(16)**	(5)	(1)
Unallocated corporate expenses	**(110)[b]**	(71)[b]	(49)[b]
	$ 241	$ 372	$ 252

	Identifiable Assets		
	1997	1996	1995
United States	**$3,637**	$4,566	$ 4,883
International	**1,461**	1,954	2,025
	$5,098	$6,520	$ 6,908

	Depreciation and Amortization		
	1997	1996	1995
United States	**$ 393**	$ 472	$ 519
International	**143**	149	152
	$ 536	$ 621	$ 671

	Capital Spending		
	1997	1996	1995
United States	**$ 385**	$ 466	$ 530
International	**158**	161	184
	$ 543	$ 627	$ 714

(a) Includes the fourth quarter charge in 1997 of $530 million (United States - $248 million, International - $282 million), other unusual charges related to disposal of the Non-core Businesses in 1997 and 1996 of $54 million and $246 million, respectively, in the United States and the initial impact of adopting SFAS 121 in 1995 of $457 million (United States - $320 million, International - $137 million). See Note 4.

(b) Includes amounts allocated by PepsiCo prior to the Spin-off of $37 million, $53 million and $52 million in 1997, 1996 and 1995, respectively.

The financial data reported above is materially consistent with restaurant segment information previously reported by PepsiCo. Adjustments have been made to these amounts primarily to remove the impact of the restaurant distribution business previously included by PepsiCo in its restaurant segment, and to include the investment in and our equity income (loss) of unconsolidated affiliates within the international segment. This change was made to align our reporting with the way we view our international business.

Note 16 – Pro Forma Financial Information (Unaudited)

As discussed in Note 3, we became an independent, publicly owned company on October 6, 1997 as a result of the Spin-off from PepsiCo. In connection with the Spin-off, we paid $4.5 billion to PepsiCo as repayment of certain amounts due to PepsiCo and as a dividend. Such payment was funded by advances of $4.55 billion under a five-year $5.25 billion bank credit agreement drawn on October 6, 1997. See Note 9. The following unaudited pro forma information presents a summary of consolidated results of operations as if the Spin-off and related transactions had occurred at the beginning of fiscal 1997:

	As Reported 1997	Pro Forma Adjustments	Pro Forma 1997
Total revenues	**$9,681**	$(268)	$9,413
Total costs and expenses	**9,440**	(303)	9,137
Operating profit	**241**	35	276
Interest expense, net	**276**	41	317
Loss before income taxes	**(35)**	(6)	(41)
Net loss	**(111)**	(6)	(117)
Loss per common share	**$ (.73)**		$ (.77)

These unaudited pro forma results have been prepared for informational purposes only and include the following adjustments to historical results:

(1) Elimination of the effect of our Non-core Businesses.

(2) Additional estimated general, administrative and other expenses of $20 million, which we would have incurred as an independent, publicly owned company, based on our analysis, partially offset by non-recurring TRICON start-up costs of approximately $14 million.

(3) Elimination of the PepsiCo interest expense allocation of $188 million and recording of interest expense of $232 million based on the $4.55 billion of external debt.

(4) Estimation of the income tax impact for the pro forma adjustments (1), (2) and (3).

The shares used to compute pro forma loss per common share were based upon 152 million shares, assuming the shares issued at Spin-off had been outstanding from the beginning of fiscal 1997. The dilutive effect of any options has been excluded due to the loss from operations, as required by SFAS 128.

Pro forma balance sheet information has not been provided as the Spin-off and related transactions have been reflected in the accompanying 1997 Consolidated Balance Sheet.

These unaudited pro forma results do not purport to be indicative of the results of operations which actually would have resulted had the transactions occurred at the beginning of fiscal 1997 or of our future results of operations.

Note 17 – Commitments and Contingencies

We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. We believe that the ultimate liability, if any, in excess of amounts already recognized arising from such claims or contingencies is not likely to have a material adverse effect on our annual results of operations, financial condition or cash flows.

We were directly or indirectly contingently liable in the amounts of $302 million and $150 million at year-end 1997 and 1996, respectively, for certain lease assignments and guarantees. In connection with these contingent liabilities, after the Spin-off Date, we were required to maintain cash collateral balances at certain institutions of approximately $30 million, which is included in Other Assets in the accompanying Consolidated Balance Sheet. At year-end 1997, $200 million represented contingent liabilities to lessors as a result of our assigning our interest in and obligations under real estate leases as a condition to the refranchising of Company restaurants. The $200 million represented the present value of the minimum payments of the assigned leases, excluding any renewal option periods, discounted at our pre-tax cost of debt. On a nominal basis, the contingent liability resulting from the assigned leases was $294 million. The balance of the contingent liabilities primarily reflected guarantees to support financial arrangements of certain unconsolidated affiliates and other restaurant franchisees.

We are currently and, for a significant portion of the prior three years ended December 27, 1997, have been primarily self-insured for most workers' compensation, general liability and automotive liability losses, subject to per occurrence and aggregate annual liability limitations. During 1997, prior to the Spin-off, we participated with PepsiCo in a guaranteed cost program for certain coverages. We are also primarily self-insured for health care claims for eligible participating employees subject to certain deductibles and limitations. We determine our liability for claims reported and for claims incurred but not reported on an actuarial basis.

Note 18 - Selected Quarterly Financial Data
(unaudited)

	1997				
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**	**Total**
Revenues:					
Company sales	**$2,123**	**$2,214**	**$2,164**	**$2,611**	**$9,112**
Franchise and license fees	**114**	**139**	**136**	**180**	**569**
Total costs and expenses	**2,075**	**2,121**	**2,105**	**3,139**	**9,440**
Operating profit (loss)	**162**	**232**	**195**	**(348)**	**241**
Net income (loss)	**52**	**121**	**79**	**(363)**	**(111)**
Loss per common share[a]				**(2.39)**	
Net income (loss) attributable to:					
Facility actions net gain (loss)	**6**	**65**	**43**	**(277)**	**(163)**
Unusual charges		**(22)**	**(12)**	**(125)**	**(159)**

(a) Earnings per share data has not been provided for periods prior to the fourth quarter of 1997 as we were not an independent, publicly owned Company prior to the Spin-off.

	1996				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues:					
Company sales	$2,171	$2,271	$2,329	$2,967	$9,738
Franchise and license fees	102	111	119	162	494
Total costs and expenses	2,127	2,199	2,252	3,282	9,860
Operating profit (loss)	146	183	196	(153)	372
Net income (loss)	40	66	60	(219)	(53)
Net income (loss) attributable to:					
Facility actions net gain (loss)	28	13	15	(35)	21
Unusual charges	(17)			(172)	(189)

See Note 4 for details of facility actions net gain (loss) and unusual charges.

Management's Responsibility for Financial Statements

To Our Shareholders:

We are responsible for the preparation, integrity and fair presentation of the Consolidated Financial Statements, related notes and other information included in this annual report. The financial statements were prepared in accordance with generally accepted accounting principles and include certain amounts based upon our estimates and assumptions, as required. Other financial information presented in the annual report is derived from the financial statements.

We maintain a system of internal control over financial reporting, designed to provide reasonable assurance as to the reliability of the financial statements, as well as to safeguard assets from unauthorized use or disposition. The system is supported by formal policies and procedures, including an active Code of Conduct program intended to ensure employees adhere to the highest standards of personal and professional integrity. Our internal audit function monitors and reports on the adequacy of and compliance with the internal control system, and appropriate actions are taken to address significant control deficiencies and other opportunities for improving the system as they are identified.

The financial statements have been audited and reported on by our independent auditors, KPMG Peat Marwick LLP, who were given free access to all financial records and related data, including minutes of the meetings of the Board of Directors and Committees of the Board. We believe that management representations made to the independent auditors were valid and appropriate.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, provides oversight to our financial reporting process and our controls to safeguard assets through periodic meetings with our independent auditors, internal auditors and management. Both our independent auditors and internal auditors have free access to the Audit Committee.

Although no cost-effective internal control system will preclude all errors and irregularities, we believe our controls as of December 27, 1997 provide reasonable assurance that our assets are reasonably safeguarded.

Robert C. Lowes
Chief Financial Officer

Report of Independent Auditors

The Board of Directors
TRICON Global Restaurants, Inc.:

We have audited the accompanying consolidated balance sheet of TRICON Global Restaurants, Inc. and Subsidiaries ("TRICON") as of December 27, 1997 and December 28, 1996, and the related consolidated statements of operations, cash flows and shareholders' (deficit) equity for each of the years in the three-year period ended December 27, 1997. These consolidated financial statements are the responsibility of TRICON's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of TRICON as of December 27, 1997 and December 28, 1996, and the results of its operations and its cash flows for each of the years in the three-year period ended December 27, 1997, in conformity with generally accepted accounting principles.

As discussed in Note 4 to the consolidated financial statements, TRICON in 1995 adopted the provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of."

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP
Louisville, Kentucky
February 12, 1998

Selected Financial Data

(in millions except share and unit amounts)
TRICON Global Restaurants, Inc. and Subsidiaries

	Fiscal Year Ended					
	Pro Forma[1]	As Reported				
	1997	1997	1996	1995	1994[2]	1993
Summary of Operations						
System sales (excluding Non-core Businesses)						
U.S.	**$13,500**	**13,500**	13,400	13,200	12,600	11,900
International	**7,000**	**7,000**	6,900	6,500	5,600	5,400
Total	**$20,500**	**20,500**	20,300	19,700	18,200	17,300
Revenues						
Company sales	**$ 8,846**	**9,112**	9,738	9,813	9,170	8,118
Franchise and license fees	**567**	**569**	494	437	395	344
Total	**$ 9,413**	**9,681**	10,232	10,250	9,565	8,462
Operating profit[3]	**$ 276**	**241**	372	252	582	645
Interest expense, net	**317**	**276**	300	355	341	229
(Loss) income before income taxes[3]	**$ (41)**	**(35)**	72	(103)	241	416
Net (loss) income[3]	**$ (117)**	**(111)**	(53)	(132)	118	238
Pro forma Loss per common share[3]	**$ (.77)**	**N/A**	N/A	N/A	N/A	N/A
Cash Flow Data						
Provided by operating activities		**$ 810**	713	813	894	1,019
Capital spending		**$ 543**	627	714	1,049	968
Refranchising of restaurants		**$ 770**	355	165		
Balance Sheet						
Total assets		**$ 5,098**	6,520	6,908	7,387	6,526
Working capital deficit		**$ (805)**	(778)	(831)	(909)	(765)
Long-term debt		**$ 4,551**	231	260	267	290
Total debt		**$ 4,675**	290	404	395	416
Investments by and advances from PepsiCo		**$**	4,266	4,604	4,962	4,366
Other Data						
Number of restaurants at year-end (excluding Non-core Businesses)						
System		**29,712**	29,096	27,894	26,212	23,927
Company		**11,207**	12,883	13,466	13,209	11,230
U.S. Company same store sales growth						
KFC		**2 %**	6 %	7 %	2 %	-
Pizza Hut		**(1)%**	(4)%	4 %	(6)%	5%
Taco Bell		**2 %**	(2)%	(4)%	2 %	6%
Shares outstanding at year-end (in millions)		**152**	N/A	N/A	N/A	N/A
Market price per share at year-end		**$28 5/16**	N/A	N/A	N/A	N/A

N/A – Not Applicable.

The historical consolidated financial data above includes TRICON Global Restaurants, Inc. and subsidiaries as if we had been an independent, publicly owned company for all periods presented. The selected financial data should be read in conjunction with the Consolidated Financial Statements and the Notes thereto.

(1) The pro forma data is derived from the unaudited pro forma financial information included in Note 16 to the Consolidated Financial Statements. The pro forma data does not purport to represent what our financial position or results of operations would have been had we operated as an independent, publicly owned company, nor does it give effect to any events other than those described. The pro forma data also does not purport to project our financial position or results of operations as of any future date or for any future period. The pro forma data reflects adjustments to eliminate our Non-core Businesses disposed of in 1997 and to reflect the estimated additional interest expense and general, administrative and other expenses which we would have incurred as an independent, publicly owned company.

(2) Fiscal year 1994 consisted of 53 weeks. The fifty-third week increased 1994 revenues by $172 and earnings by approximately $23 ($14 after-tax).

(3) Includes combined facility actions and unusual charges of $421 ($322 after-tax), $209 ($168 after-tax) and $402 ($295 after-tax) for 1997, 1996 and 1995, respectively. On a pro forma basis, 1997 includes combined facility actions and unusual charges of $367 ($288 after-tax or $1.90 per share). See Note 4 to the Consolidated Financial Statements.

Shareholder Information

Annual Meeting:

The Annual Meeting of Shareholders will be at TRICON Headquarters, Louisville, KY at 9:30 a.m. (EDT), Tuesday, May 19, 1998. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

Inquiries Regarding Your Stock Holdings

Registered Shareholders (shares held by you in your name) should address communications concerning statements, dividend payments, address changes, lost certificates and other administrative matters to:

TRICON Global Restaurants, Inc.
c/o Boston Equiserve, L.P.
P.O. Box 8038
Boston, MA 02266-8038
(888) 439-4986

OR

James B. Alterman
Manager Shareholder Relations
TRICON Global Restaurants, Inc.
1441 Gardiner Lane
Louisville, KY 40213
(888) 2YUMYUM
Internet: www.triconglobal.com

In all correspondence or telephone inquiries, please mention TRICON, your name **as printed on your statement or stock certificate**, your social security number, your address and telephone number.

Beneficial Shareholders (shares held in the name of your bank or broker) should direct communications on all administrative matters to your stockbroker.

TRICON SharePower Participants (employees with SharePower options) should address all questions regarding their account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower
Stock Option Plan Services
P.O. Box 30466
New Brunswick, NJ 08989-0446
Telephone: (800) 637-2432 (U.S., Puerto Rico and Canada)
(732) 560-9444 (all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your social security number), your address, your telephone number and mention TRICON SharePower. For telephone inquiries, please have a copy of your most recent statement available.

Employee Benefit Plan Participants

Capital Stock Purchase Plan	*(888) 875-4015*
SaveUp 401(k)	*(888) 875-4015*
Tricon Savings Center	*(617) 847-1013*
P.O. Box 1389	*(outside U.S.)*
Boston, MA 02104	

Please have a copy of your most recent statement available when calling. Press ∗0 for a customer service representative and give the representative the name of the Plan.

Shareholder Services

Optional Cash Investment

A brochure explaining this convenient plan, for which TRICON pays all administrative costs, is available from our transfer agent:

Boston Equiserve, L.P.
P.O. Box 8038
Boston, MA 02266-8038 *(888) 439-4986*

Low-Cost Investment Plan

Investors may purchase their initial share of stock through NAIC's Low-Cost Investment Plan. For details contact:

National Association of Investors Corporation (NAIC)
711 West Thirteen Mile Road
Madison Heights, MI 48071 *(248) 583-NAIC (6242)*

Financial and Other Information

Earnings and other financial results, corporate news, and other company information are available on TRICON's web site: **www.triconglobal.com**

Copies of TRICON's SEC Form 8-K, 10-K and 10-Q reports and quarterly earnings releases are available free of charge. Contact TRICON's Manager of Shareholder Relations at (888) 2YUMYUM.

Securities analysts, portfolio managers, representatives of financial institutions and other individuals with questions regarding TRICON's performance are invited to contact:

Lynn A. Tyson
Vice President, Investor Relations
TRICON Global Restaurants, Inc.
1441 Gardiner Lane
Louisville, KY 40213 *(502) 874-8617*

Independent Auditors
KPMG Peat Marwick LLP
400 West Market Street, Suite 2600
Louisville, KY 40202 *(502) 587-0535*

Capital Stock Information

Stock Trading Symbol - YUM

The New York Stock Exchange is the principal market for TRICON Common stock.

Shareholders

At year-end 1997, there were approximately 185,000 shareholders of record.

Dividend Policy

TRICON does not currently pay dividends, nor does it anticipate doing so in the near future.

Spin-off Information:

Opening stock price on September 17, 1997: 28 3/4. First day of trading on the NYSE on an "when issued basis."

Cost Basis TRICON Spin-off from PepsiCo

PepsiCo shareholders should allocate 92.4068 percent of their PepsiCo stock basis immediately prior to the Spin-off to their PepsiCo shares, and 7.5932 percent of their PepsiCo stock basis immediately prior to the Spin-off to the TRICON shares received in the Spin-off.

Spin-off date: Monday, October 6, 1997

Top row left to right: *Kenneth G. Langone, Massimo Ferragamo, James Dimon, Andrall E. Pearson, Robert J. Ulrich, Jackie Trujillo and D. Ronald Daniel.*

Bottom row left to right: *Jeanette S. Wagner, Robert Holland, Jr., David C. Novak, Sidney Kohl and John L. Weinberg.*

Board of Directors

D. Ronald Daniel, 68
Vice President, Harvard University and former Managing Director of McKinsey and Company

James Dimon, 42
President, Chief Operating Officer and Director of Travelers Group

Massimo Ferragamo, 40
President and Vice Chairman of Moda Imports, Inc., the U.S. subsidiary of Salvatore Ferragamo Italia, a luxury goods producer and retailer

Robert Holland, Jr., 56
Owner and Chief Executive Officer of Workplace Integrator's, Michigan's largest Steelcase office furniture dealer

Sidney Kohl, 67
Former Chairman of Kohl's Supermarkets and founder of Kohl's Department Stores

Kenneth G. Langone, 62
Founder, Chairman of the Board and Chief Executive Officer of Invemed Associates, Inc., an investment banking firm, and founder of Home Depot, Inc.

David C. Novak, 44
Vice Chairman and President, Tricon

Andrall E. Pearson, 72
Chairman and Chief Executive Officer, Tricon

Jackie Trujillo, 62
Chairman of the Board of Harman Management Corporation, one of KFC's largest franchisees

Robert J. Ulrich, 54
Chairman and Chief Executive Officer of Dayton Hudson Corporation and Target Stores

Jeanette S. Wagner, 68
President of Estée Lauder International, Inc.

John L. Weinberg, 73
Senior Chairman of Goldman, Sachs & Company

Officers

Andrall E. Pearson, 72
Chairman and Chief Executive Officer, Tricon

David C. Novak, 44
Vice Chairman and President, Tricon

Peter A. Bassi, 48
President, Tricon Restaurants International

Jonathan D. Blum, 39
Senior Vice President Public Affairs, Tricon

Christian L. Campbell, 47
Senior Vice President, General Counsel and Secretary, Tricon

Robert L. Carleton, 57
Senior Vice President and Controller, Tricon

Thomas E. Davin, 40
Chief Operating Officer, Taco Bell USA

Gregg R. Dedrick, 38
Chief People Officer, Tricon

Aylwin B. Lewis, 43
Chief Operating Officer, Pizza Hut USA

Robert C. Lowes, 52
Chief Financial Officer, Tricon

Jeffrey A. Moody, 39
President and Chief Concept Officer, KFC USA

Charles E. Rawley, 47
Chief Operating Officer, KFC USA

Michael S. Rawlings, 43
President and Chief Concept Officer, Pizza Hut USA

Peter C. Waller, 43
President and Chief Concept Officer, Taco Bell USA

Sandra S. Wijnberg, 41
Senior Vice President and Treasurer, Tricon

Franchisee Advisory Council

Linda Alvarado
Taco Bell

Allen Beebe
Taco Bell

Percy Fennell
KFC

Dick Freeland
Pizza Hut

Arthur Ho
Tricon Restaurants International

Al Luihn
KFC

Keith Sole
Tricon Restaurants International

Bill Walsh
Pizza Hut

Our Passion

Put a YUM on people's faces around the world...
that special eating *experience* that makes you smile
and creates lifelong customers. We'll do that with...

- Food you crave
- Comeback value
- Customer-focused teams

Our jobs will be the best in the world
for people who are committed to quality food
and satisfying customers better than anyone.

Tricon Yum!